MINORITY FRANCHISING: IS DISCRIMINATION A FACTOR?

Y 4. SM 1: 103-31

Minority Franchising: Is Discrimina...

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

WASHINGTON, DC, JUNE 30, 1993

Printed for the use of the Committee on Small Business

Serial No. 103-31

JUN 30 1994

U.S. GOVERNMENT PRINTING OFFICE

69-852 WASHINGTON : 1994

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-044151-X

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FACTOR?

WEDNESDAY, JUNE 30, 1993

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The committee met, pursuant to notice, at 9:21 a.m., in room 2359-A, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the committee) presiding.

Chairman LAFALCE. The Small Business Committee will come to order. The Small Business Committee has endeavored to provide the Congress with an appreciation of the growing significance of business franchising in our Nation's economy, as well as an understanding of serious problems that can arise in franchise sales and franchise business relationships. Issues related to minority ownership of franchises have been a particular focus of committee concern.

Small business has long provided one of the most effective and accessible vehicles for economic advancement for minorities, and franchising is gaining increasing attention as a means to facilitate new small business growth and minority business ownership.

In a November 1991 hearing on minorities and franchising, the committee received testimony documenting the disproportionately low representation of minorities among franchise owners. According to data produced by the Department of Commerce in the mid-1980's which remains the most recent comprehensive analysis of franchise ownership, less than 2 percent of more than 478,000 franchise outlets were minority-owned.

While significant efforts have been undertaken since the mid-1980's to recruit minority owners in many franchise systems, franchise ownership by minorities remains, by most estimates, below 3 percent of all franchise units.

Witnesses offered the committee a variety of explanations for this low representation of minorities among franchise owners. Several cited the limited investment opportunities available to minorities caused by a lack of franchisor interest in minority markets, institutional bias against minority owners, and lack of programs to recruit minority franchisees. Recruitment of minority franchisees was described as superficial at best in many franchise systems, while in other systems minority franchise development was considered risky business and not viewed as a natural course of doing business.

Lack of access to affordable capital was also cited as a key factor not only excluding many minority applicants from acquiring franchises, but also restricting minority ownership to lower cost and less profitable franchise locations. As one witness concluded, "minorities have less capital, and therefore less opportunities."

Another witness commented, "our opportunities are usually limited to what we are presented, but this may be the only opportunity we will get."

Even more disturbing was testimony highlighting what one witness termed "the unmistakable pattern of discriminatory and abusive practices" that many minority franchisees encounter after purchasing a franchise business. Witnesses described several troubling practices: First, the red lining or steering of minority franchisees to low income, depressed or minority communities while reserving more lucrative locations for white franchisees; second, deceitful bait and switch tactics to trick minority franchisees into accepting inferior store locations; third, discriminatory pricing and leasing policies that impose higher costs on minority owners; fourth, inadequate understanding of minority markets and inappropriate training, products, advertising, and support for such markets; and, fifth, use of arbitrary or discriminatory grading systems and other tactics to limit expansion opportunities for minority owners.

The purpose of today's hearing is at least twofold. First, to obtain additional documentation regarding these patterns of institutional bias and discriminatory practices within franchise systems, and, second, to address the question of whether such conduct has been a factor in limiting the availability of franchise opportunities for minority investors and in inhibiting the successful or profitable operation of franchise businesses by minority owners.

Discrimination in franchise sales and franchising practices is a serious and troubling issue. Unlike other questions in franchising, such as mandated sources of supply or pricing policies, discrimination is not a question to be debated, nor an issue on which there should be sides. It is illegal under Federal law, it is immoral, and it is something we should all oppose. If evidence of discrimination exists, even if limited to the cases examined today, it is a problem that must be addressed.

In addition to the testimony from the previous hearing, the committee has received many complaints regarding discriminatory practices in a number of franchise systems. Recent news articles have also highlighted some serious patterns of discrimination within a number of major franchise companies. I am convinced that ample evidence exists of such practices and have therefore sought to include strong antidiscrimination provisions in the franchise disclosure and relationship proposals that I have introduced in Congress.

I know these concerns are shared by many members of this committee, and most especially by Mr. Mfume, Mrs. Clayton, and Mrs. Roybal-Allard, who spoke eloquently to these concerns in our last hearing and who have cosponsored the franchise legislation I have introduced. I would like to express my special appreciation to them for their support.

Many allegations have been made that serious problems of discrimination exist in franchising. Our purpose today is to assess if this is true, to understand how it is manifested in franchise sales and practices and to determine what needs to be done to eliminate it. We have with us today a diverse and extremely capable panel of witnesses to discuss these important questions. The committee looks forward very much to hearing their testimony and their recommendations.

Before we turn to the panel, though, Mrs. Meyers has an opening statement. It is my hope that she will be here later. We will put her statement in the record at this point in time, reserving the right for her to read it at any time she appears if that is her desire. We will also include the statement of Mr. Ramstad at this point in the record.

[Mrs. Meyers' and Mr. Ramstad's statements may be found in the appendix.]

Mr. BILBRAY. Just a point. I appreciate the chairman continuing these important hearings on this matter, I believe it is a serious problem. I am anxious to hear the testimony of the witnesses today.

Chairman LAFALCE. Thank you very much. I might point out we were in session until 1 o'clock Monday night, 11 p.m. last night. There is a Democratic caucus going on right now. I am not sure if there is a Republican conference. It is difficult to be every place at once. The Chairmen don't have any choice, though.

[Chairman LaFalce's statement may be found in the appendix.]

Chairman LAFALCE. We will now hear from our panel. We have Mr. Anthony Robinson, president, Minority Business Enterprise Legal Defense and Education Fund; Mr. Kerry Scanlon, counsel for the NAACP Legal Defense Fund; Ms. Jacquelyn Gates, immediate past president of the National Association of Negro Business and Professional Women's Clubs; Joseph Sánchez, a former franchisee with McDonald's, Nitin Shah, president of the Asian American Hotel Owners Association; Patricia Grant, a former franchisee, Hair Performers; Mr. Eugene Brown, vice president of the Capital Area Franchise Owners Association, Landover, Maryland.

Oh, I am advised that Mr. Brown at the very last minute said he couldn't come or was persuaded not to come. What I think we will do, is just go from right to left, Mr. Robinson.

TESTIMONY OF ANTHONY W. ROBINSON, PRESIDENT, MINORITY BUSINESS ENTERPRISE LEGAL DEFENSE AND EDUCATION FUND

Mr. ROBINSON. Good morning, Mr. Chairman and members of this distinguished committee, my name is Anthony Robinson. As you have indicated, I am president of the Minority Business Enterprise Legal Defense and Education Fund. MBELDEF is a national nonprofit public interest law firm that was founded in 1980 by the former chairman of this committee, the Honorable Parren J. Mitchell. The principal mission of MBELDEF is to defend and protect the class interests of the minority business community through litigation.

Initially MBELDEF's litigation efforts were focused exclusively upon defending the constitutionality of minority business pro-

grams. However, in more recent years, our litigation agenda has broadened considerably to include lawsuits to enforce the implementation of minority business programs and also to attack discrimination in the marketplace. It is in this latter context that MBELDEF gained considerable experience with the plight of minority franchisees, and from this experience that I come to offer testimony today.

Our first encounter with discrimination against minority franchisees came in 1988 when a number of minority franchisees with the Burger King Corp., expressed deep frustration and anger about the systematic and pervasive patterns of discrimination that undermined their survival. At first there were a dozen minority franchisees which included about 24 black, Hispanic, and Asian-Indian franchisees in the Burger King system that came forward to address these concerns. Those 24 plaintiffs represented a prospective class of hundreds of past and present minority-owned franchisees within the Burger King system.

When we filed that massive class action lawsuit in October of 1988, it received extensive press coverage, and as a result of that press coverage we were deluged with calls from all across the Nation from former and present minority franchise owners who had suffered similar experiences. At first there were calls from franchisees in major fast food restaurant chains, then there were calls from minority-owned car dealerships.

Finally, a group of black 7-Eleven franchise owners from the Maryland, DC, and Virginia area approached us to evaluate litigation options in their regard. Ultimately they decided not to pursue litigation. The commonality of complaints from the minority franchisee community was astounding. Regardless of the region or type of franchise, the unmistakable pattern of discriminatory and abusive practices were quite evident. Almost to a person, each minority franchisee complained that their franchisor engaged in a variety of discriminatory conduct which included red lining and steering most minority franchisees to low income, depressed urban locations, while reserving more lucrative locations for white franchisees; price discrimination in charging minority franchisees more for the leasing and purchase of stores and equipment; use of a discriminatory and arbitrary grading system as a means of limiting and preventing the expansion of minority franchisees to more lucrative suburban markets or commercial districts; deceitful bait and switch tactics to trick the minority franchisees into accepting inferior facilities and store locations; and vicious retaliation against those minority franchisees that dare to complain about the discriminatory treatment.

As a result of these practices, many minority franchisees find themselves in a financially vulnerable position. Their cash-flow is negative. Due to depressed sales and substantially higher costs than their white counterparts, they frequently are unable to meet all of their financial obligations under their franchise agreements. As a result, minority franchisees can often find themselves at the mercy of the franchise source that set them up for failure in the first place.

Under the terms of most franchise agreements, the franchisor has the option of terminating the franchise agreement and seizing

property and equipment if the franchisee misses even a single payment. When minority franchisees have filed suit against the discriminatory treatment, retaliation has been swift and harsh. Several were forced and have been forced into bankruptcy.

Our judicial system has proven woefully inadequate to protect these franchisees from retaliation. Motions for preliminary injunctions to prevent termination of franchise agreements have not even been responded to by the court or were not responded to by the court in over 3 years of litigation. Moreover, after 3 years of litigation and hundreds of thousands of dollars in legal fees, the case has yet to go to trial.

Several of the Burger King plaintiffs have gone out of business in the interim. Perhaps the far-reaching implications of an overburdened and nonresponsive judicial system should be the subject of another hearing before this committee. However, the sad reality makes it imperative for this committee and the Congress to act immediately to provide greater protection to these minority franchisees.

MBELDEF urges this committee to consider several remedial approaches. New legislation for fairness in franchising is sorely needed. The features of such legislation should include requirements for franchisers to make full disclosures to prospective franchisees regarding sales history and sales projections for franchise locations. There should also be a prohibition against unfair trade practices in franchising, such as price discrimination, bait and switch tactics, and the intentional refranchising of hopelessly unprofitable sites. Moreover, the Federal Trade Commission should be directed to engage in rulemaking or conduct investigations to enforce this legislation.

Due to the grossly inferior bargaining position of franchisees, it might also be useful to create an independent franchise arbitration board to resolve franchisee complaints of this nature. An antidiscrimination statute to outlaw red lining of minority franchisees and impose criminal penalties would also be beneficial.

Finally, we urge this committee to hold annual oversight hearings to monitor the financial health of minority franchisees and the enforcement actions of the FTC in this area. While I recognize that this is a tall order to undertake, I sincerely hope that my testimony here today has at least been somewhat helpful in leading you toward a vitally important first step in achieving fairness in franchising. Thank you very much.

[Mr. Robinson's statement may be found in the appendix.]

Chairman LaFalce. Thank you very much, Mr. Robinson. Our committee has been joined by a number of Members, and we have introduced the opening statement of Mrs. Meyers into the record, but I wonder if any of the others who have joined us or Mrs. Meyers want to make any statement at this time.

Mrs. Meyers. I will make a brief statement, Mr. Chairman. Like you, I am disheartened and outraged that too many people living in our country haven't quite got the message, all men and women are created equal and are to be treated as such regardless of race, creed, color, or national origin. In our zeal to ferret out these wrongs, we should make sure we are placing the blame at the right

door step. Is it franchising as a system that is at fault or is a few unethical individuals who are creating problems?

I don't mean to trivialize the matter, but we need to discern between the bath water and the baby. To date the committee has received anecdotal evidence of problems, but I believe we are still far from finding true, really widespread abuse. We should remember that franchising has offered countless individuals of all walks of life the opportunity to buy their own business on the main streets of rural America and on the avenues of our Nation's cities. Beyond that, many of our country's franchisers actively recruit minorities and provide outstanding assistance to help them succeed and to achieve the American dream.

If we move too hastily to condemn the system, perhaps wrongly, we may cut thousands of individuals off from the very types of opportunities we are trying to provide. I have no doubt that some franchisers and some franchisees maybe have discriminated against minorities and others. It is sad to say, but some nonfranchising companies have, too, as have private independent shops, as have individual citizens. Discrimination is reprehensible wherever and however it occurs, but before we take action against it let's make sure we are shooting at the right target and aiming accurately.

Franchising has paved the road of opportunity for thousands of minorities, and I think we would be wise to do all we can to keep the road open and do away with the abuses.

Chairman LaFalce. Thank you very much.

Mr. Tucker?

Mr. Tucker. Thank you very much, Mr. Chairman. I will first defer to my colleague over there.

Chairman LaFalce. Mr. Dickey.

Mr. Dickey. Thank you, Mr. Chairman.

Chairman LaFalce. Who has, I think, some special expertise in this area.

Mr. Dickey. I would like to state that I have had, I think, five franchises. I have been a franchisee in five different circumstances. I am presently a franchisee in three. I am in agreement, I feel somewhat relieved that I get a chance to say these things that I am going to say about the minorities and about franchisees because I haven't had the opportunity before.

What I have found in my dealings with the franchisers is that they somehow feel like they can inch into oppression. They can bring the franchisees into submission just by we will try this and we will try that and we will see what they will put up with as a group or individually. They have tried in my instances to divide us in various different ways by promising expansion for some people and not expansion to others. If you complain a whole lot you get either shut out or you get benefits. It is a constant looking around that you have to do in the franchise business to see what in the world a franchisor is about.

I have noticed something in my latest dealings with them that they refuse to put anything in writing, that that is an absolute positive that you will say, well, send me something on that or something like that, so what I have started doing is sending letters to them saying this is what we have discussed. If it is anything dif-

ferently, let me know, so I will get a call back and they will say well that wasn't necessarily the right thing, but we will operate on it, and I say well, what was different about it, what was wrong with it, and I won't get that, I won't get a response.

The refusal to renew is hanging over our heads constantly, constantly that we might not be able to renew or we may cause you to want to scrape and build and put something else here. The financial developmental requirements that are made on us are another way of trying to move us out when the time comes. I have had the circumstances with Taco Bell where they have offered to buy my two stores. Well, that puts a person in a very precarious position. We will get around to the minorities in a minute, so be patient with me, but it puts you——

Chairman LaFalce. I ask unanimous consent the gentleman be given an additional 30 minutes.

Mr. Dickey. I am sorry, Mr. Chairman.

Chairman LaFalce. No, that is OK.

Mr. Dickey. I feel very strongly about this, but I want you to think about a franchisee who the franchisor comes in and says I want to buy your stores, and we will offer you this amount and the amount is not the value, the position before you answer is if I answer no will they come after me or will they not. It has never been done, nothing has ever been done that was wrong in that circumstance, but when I refused to sell, I was watching over my shoulder constantly and having to look very carefully to what their reaction might be.

Now, here is what—as far as the minorities are concerned, I hire almost 97 employees in my franchises. Ninety-five percent of that 97 employees are minorities. I hired a manager of the two Taco Bells is a minority and one of the finest managers the Nation has in the Taco Bell system. I want to pledge to you all that whatever experience I have had, whatever experience my minority operators and managers have had and supervisors is yours, wherever it might be that you need help, we will do whatever we can to make that available. It is a sort of thing that if you are a minority and if you are a franchisee you have got a double hit against you, and I know that these hearings—and I want to commend the Chairman, these hearings will give us some way of expressing these frustrations and doing something about it both from a minority standpoint and giving people a chance and an opportunity to serve people and to win the battles that you have to win across the counters without the oppression that comes from franchisers.

Now, that is all I am going to say on the negative side. From the positive side, I have had a very rewarding experience as being a franchisee in both the Baskin Robbins franchise and the Taco Bell. There are worlds of good that can come from cooperation between a franchisor and the franchisee, when you look at the customer and you keep the customer in line and mind and it should be encouraged, and I agree with Mrs. Meyers that it is the sort of thing that we cannot just go and just cut the whole thing off, cut the vine off because you have got to have the expertise of the franchisers, so any legislation that we would have that would discourage them would be wrong, but something needs to be done to protect the franchisee and give the minority the hope that he or she

can, in fact, enter into this area without this being run into the ground. Thank you.

Chairman LaFalce. I want to thank you very much for that statement, Mr. Dickey. You may have done more good in your 5 to 10 minutes today than we have done in the past 2 years in trying to convince the world of problems that exist within an industry that has been so great and has so much potential for future greatness.

Anybody else want to make any opening statements? Mr. Tucker?

Mr. Tucker. Thank you very much, Mr. Chairman. I most certainly appreciated the comments by my colleague, Mr. Dickey, and his expertise in this area, his experience. I want to thank this group of participants and witnesses for coming to testify to us and enlightening us in the area of these problems not only as it relates to minorities for the sake of they being minorities, but also as minorities who happen to be franchisees. Obviously this is a problem, as Mr. Dickey indicated, that affects minorities but also affects you because you are franchisees, and so I appreciate not only you pointing to the problems that are existing out there, but more importantly to the solutions and recommendations as to what this body and even a larger body may be able to do to try to ameliorate the environment out there for franchisees who happen to be minorities or franchisees who do not happen to be minorities. I do appreciate some of the suggestions, particularly on your last page, Mr. Robinson, and hopefully this body will take that to heart and not try to in any way sidestep the real issue which is that there are some unfair trade practices going on whether or not you happen to be a minority. Thank you very much, Mr. Chairman.

Chairman LaFalce. Thank you very much, Mr. Tucker. I will now call upon the distinguished star of the Wall Street Journal, Mr. Kweisi Mfume.

Mr. Mfume. Well, you are very kind, very, very kind, Mr. Chairman. I have got opening statements that I would ask unanimous consent could be submitted for the record.

Chairman LaFalce. Without objection, so ordered.

Mr. Mfume. Let me just briefly thank you, Mr. Chairman, for following up on these hearings. I had a great opportunity to be educated like many others with the previous hearing. I would hope that people who are unaware of this issue or Members who are just starting to get focused on it, that they will have the same opportunity with this hearing. I think it is fair to say, Mr. Chairman, that while most franchise owners are reluctant to step forward to complain, particularly minority franchise owners about apparent abuses and other things, clearly there are a number of concerns that seem to cut to the core as I see it of the concerns of the minorities, whether they are African-American, Latin, or Asian, with respect to their relationships with the franchisers.

Primary among these claims are suggestions that, number one, an owner's ethnicity dictates where their franchise will be allowed to operate; two, that price differentials between what minorities are charged for gaining access to a franchise as opposed to their nonminority counterparts tend to differ, and, three, that arbitrary and capricious evaluation and grading procedures designed to limit

full potential expansion seems to continue. In fact, in many respects it is the old master-slave relationship all over again. So I would certainly hope that we are able to find a common ground in our efforts to pursue this.

I want to commend you for the introduction of the legislation which I am happy to join on to. I look forward to the testimony of the remaining witnesses, and I would yield back, Mr. Chairman, and submit the full statement for the record.

[Mr. Mfume's statement may be found in the appendix.]

Chairman LaFalce. Thank you. I see we have been joined by some members of the minority. Do they have any statements they wish to make at this time? Oh, you did, Mr. Talent?

Mr. Talent. I don't want to hold up the hearing, but I would like to submit my prepared statement at this time.

[Mr. Talent's statement may be found in the appendix.]

Chairman LaFalce. Ms. Danner?

Ms. Danner. No.

Chairman LaFalce. My counsel next tells me that I should call upon Mr. Kerry Scanlon, counsel for the NAACP Legal Defense Fund.

TESTIMONY OF KERRY ALAN SCANLON, ASSISTANT COUNSEL, NAACP LEGAL DEFENSE AND EDUCATION FUND

Mr. Scanlon. Good morning, Mr. Chairman and members of the committee. Thank you for this opportunity to address the committee on this important issue. I am assistant counsel at the NAACP Legal Defense Fund in the Washington office, and as the members of this committee are well aware, for more than 50 years the Legal Defense Fund has been actively involved in protecting the rights of minorities, African-Americans, and others who face discrimination in all aspects of American life, beginning with Thurgood Marshall's efforts in the area of public education.

My testimony this morning will focus on the question posed by the committee in the context of the restaurant franchise industry, and my friend, Tony Robinson, has given an excellent statement of direct experience with franchise discrimination in the case against Burger King. I personally have not litigated a franchise case, but I have had quite a bit of experience in the area of Title VII cases involving discrimination in employment practices in public accommodations, including restaurants, and there are a couple of reasons why we are focusing on restaurants this morning.

First, restaurants and fast food outlets comprise a significant percentage of all franchise units in the country. The top 50 restaurant franchise companies alone generate some $76 billion in annual revenues, and I think the figure I saw in one of the Black Enterprise articles on this was that the total amount of franchise revenues annually is approximately 10 times that or somewhere between $700 to $800 billion, so the restaurant industry is a good indicator and it is a significant part of the market.

Second, there has been a surprising and really very unfortunate trend in the past 5 or 6 years of an increase in discrimination in restaurants and places of public accommodation. Cases including Shoney's, which I will talk about briefly, Denny's which has been

in the press a lot lately, Holiday Spas which many of the Members who live in Washington have read about and the clubs around here, and the Burger King situation that Mr. Robinson spoke about. I have been involved in these cases, as I said before, from the point of view of a litigator, and the discrimination against African-Americans in these cases has included not only discrimination against employees, but discrimination against customers, which everybody by now has become familiar with. Although Title II of the Civil Rights Act prohibited this type of discrimination long ago, we are beginning to see in fact, an increase, it seems, in reported cases against black customers going into places of public accommodation. This is a very disturbing pattern, and I think that its relationship to the issue before this committee is very clear.

Obviously, if discrimination is occurring in the selection of employees and the other employment practices in these restaurants and other fast food outlets, at the management level there is a very high chance that, of course, the same types of attitudes will find themselves into the decisionmaking as to selecting franchisees and the terms and conditions of a franchise contract and its enforcement. Particularly as Congressman Dickey pointed out, many of these things are very subjective and not written down. There is a lot of opportunity for discretion to be exercised in this context, and we know from many years of civil rights cases that when largely white managers are given uncontrolled discretion, African-Americans and other minorities often end up on the short end of the deal.

Mr. DICKEY. Could I say something? Is that possible?

Chairman LAFALCE. Sure.

Mr. DICKEY. Do you mind, Mr. Scanlon?

Mr. SCANLON. Not at all.

Mr. DICKEY. Something that comes to mind that I found out in my franchising is that one instance, not with anybody I am involved with now, the pressure to get a minority franchisee was put on this particular industry, and they gave them a bad shop, so that they said, well, if they could make it, then it is going to be OK. If they don't make it, then we can use that to say, look, and whatever you said that reminded me of that. I have seen that happen absolutely, and I think it is wrong and something we ought to try to correct. Excuse me.

Mr. SCANLON. I agree with that. Third, restaurants and fast food outlets account for the highest percentage of black franchise owners, although that percentage is still very low. The Black Enterprise article I referred to, which was published in 1991 and is cited in my written testimony, reported that 49 percent of the 2,700 black-owned franchise units represented by the companies on the top 50 list sell fast food, and if discrimination is occurring in this area of franchising, certainly there is a very strong implication that it also occurs in other areas where blacks are represented even less.

I want to touch on three things briefly which are discussed in more detail in the written statement, and I would like to add that Dr. Marc Bendick, an economist here in Washington, has coauthored this testimony and is here with me at the hearing this morning. The first is the relationship between discrimination in fran-

chising and the employment practices which I mentioned. Consider the example of the Shoney's case which has been reported widely and which I believe most members of the committee have read about, in which the Legal Defense Fund represented the plaintiffs in the case that was settled recently for $132 million in back pay and other relief involving a nationwide class action challenging discrimination in the Shoney's restaurant chain.

The allegations in that case included that blacks were confined to kitchen positions and were precluded from customer contact positions such as servers; that blacks were precluded from managerial opportunities, both at the restaurant level and at the corporate central offices. There was repeated use of racial slurs and epithets. There was alleged retaliation against whites who refused to comply with company policies involving discrimination against blacks, and many of the same things that undoubtedly were reported in the Burger King case that has already been mentioned. Shoney's is the 13th largest franchise restaurant company in the Nation, operating more than 750 company-owned restaurants and 700 franchise restaurants in 35 States.

In affidavits and statements submitted in that litigation, discriminatory practices were attributed to several hundred named company supervisors and managers and employees throughout this chain. Although it is often said by defendants in these cases that it is just an extreme case or someone acting out of the ordinary, these were clearly policies in this case that were coming from a central location. This was not an individual rogue franchisee who was operating outside the central policies of the company. These allegations, in fact, included involvement by the company's former chairman and chief executive officer.

One of the ways that employment practices like this limit opportunities is that in the selection of franchisees, oftentimes companies will prefer persons with prior managerial experience within the company's own system or if not in that company, within the restaurant industry in general. Because in these restaurant chains, and I am certainly not limiting my comments to Shoney's by any means, the vast majority of these managers are white, this practice has a strong adverse impact on African-Americans and other minorities in terms of their opportunities to receive franchises in the first place. Again, as was already stated, the process of selecting franchisees is something that we don't know very much about in terms of the numbers who are qualified who are African-American and the numbers who are selected.

One of the very first things we need to know is an answer to this question, and that is something which the reporting requirements called for in this bill would provide great assistance in doing. Even when minorities have the proven and accumulated experience as managers in the restaurant industry, oftentimes they are not hired or promoted to the higher level positions. Tests have been done throughout the country, and this committee is familiar with testing both in employment and housing, and in the restaurant industry the best estimates are that at least 25 percent of the time discrimination occurs even in the selection for lower level positions in the restaurant business. That is to say, every time a minority goes out

and seeks a job in one of these positions, there is at least a one in four chance that he or she will face discrimination because of race.

These testing studies have been conducted primarily for relatively low level positions, such as servers, hosts, and assistant managers. For the more senior managerial jobs that oftentimes lead to obtaining franchises, a substantially higher rate of discrimination undoubtedly prevails. This is also an industry in which, from my experience in these cases, it is quite clear that people are promoted from within. They don't normally go out and hire their top people, but they have people who have come up through the system, almost always white, and many of these white employees are not people who have gone to graduate school. Many of them never completed high school. The training and the education for this business is often provided within the company, within the franchise system, and there is simply no explanation why there would be such a low percentage of blacks in these managerial positions given that fact, and the selection of franchisees that stems from that.

The second point I would like to refer to is the impact of financing. As everybody knows, potential franchisees typically must provide a front-end investment to cover some of the initial franchise fees, the acquisition of real estate and equipment, working capital, and other costs, and in the restaurant industry this can range anywhere from $100,000 to $1 million. However, this can often be borrowed, in order to get a franchise, you don't have to have that much money. You can borrow it, and unfortunately there is well-documented evidence already that there has been discrimination, continuing discrimination in the procurement of capital in this country. In fact there have been numerous articles related to real estate lending and other matters just in the past couple of months that I am sure the committee has seen, and this pattern in the financial market is documented in some of the studies cited in footnote nine on page 7 of our testimony. I don't think the committee needs to dwell very long on that particular point because it has been taken up in other committees of this Congress, but the concern about discrimination in obtaining financing has a direct relationship to the question of franchising because it is so important in order to be able to obtain one of these franchises.

Second, the question of financing is particularly important here because it is not just banks and lending institutions which are involved. The franchise companies often control millions if not billions of dollars in funds that they can make available to franchisees or potential purchasers, and indeed this is one of the points that is sometimes made as part of their offer, that they can make this financing available. They can give discounts in rates. They can do a lot of things to make sure that someone who is qualified, in fact, receives the money.

Mr. DICKEY. Let me say something in that regard. The leverage that the franchisor has on other lenders is also a factor, and also suppliers in how you pay back, you see, whether or not you have 90 days or 30 days. Those things can be done if a franchisor is trying to encourage someone to get into it or if they are competing to get that person into the franchise, those things will be mentioned.

Mr. SCANLON. That is right, and the point of leverage is also mentioned in our testimony. I think that is an excellent thing to

point out because there is a tremendous disparity in the amount of power in this relationship between the franchisor and the franchisee, and this situation is ripe for discrimination because the franchisee, particularly when they are at a disadvantage to begin with because of the location of the restaurant or the outlet or the terms and conditions of the contract, oftentimes is basically struggling to survive and doesn't have the kind of power to exercise that is anywhere close to what the franchisor possesses.

I know there are a lot of other witnesses, so let me just wrap up quickly and mention the third point which is the discrimination in the terms and conditions of the contract and the continuing relationship. One of the things that is in fact unique about the franchise situation and one reason why it is a good opportunity for many minority businesses to go into is because there is, in many ways, less risk involved. The failure of franchises is, I think, according to one article, only half of that of independent businesses. There is a continuing relationship that is provided, continuing advertising at the national level that is provided by the franchisor. It is an excellent opportunity for African-Americans and other minorities, particularly in the economy that we are now facing.

Mr. DICKEY. Controlling the labor market, too, you see, relating to the labor market is extremely important in some areas.

Mr. MFUME. Mr. Chairman, a point of order.

Mr. DICKEY. Am I disturbing you enough?

Mr. SCANLON. Not at all.

Mr. MFUME. On a point of order, I know my dear friend from Arkansas is anxious to participate and fortunately is on the right side of this issue. Many of us on this side, Mr. Chairman, are following standard format and while we have questions for the gentleman giving testimony, we are yielding until the Chair recognizes us. I would simply ask my friend if he would allow us to adhere to that format or if we are going to change it, then to allow us to get questions in also.

Mr. DICKEY. Just tape up my mouth and I will do it.

Chairman LAFALCE. Because of the fact that I try to allow for everybody an opportunity to have full participation, our procedure will often vary from panel to panel depending on the number of Members present here, the number of witnesses, et cetera. Given the fact that we do have so many Members listening to the hearing and we do have so many witnesses, perhaps we should be a bit more structured. So let's hear from the witnesses, then we will proceed under the 5-minute rule.

Mr. SCANLON. Fine. I will wrap up very quickly, Mr. Chairman. The one point I will make on this third area involving the terms and conditions is the location of the restaurant or the outlet involved. This oftentimes is a very important factor in terms of whether or not the unit is going to be profitable, and as has already been mentioned there is oftentimes discrimination simply in the assignment of these franchise units, placing minority franchise owners in inner-city locations which are oftentimes not as profitable.

Now, that is not always true because sometimes, as our testimony points out, inner-city locations provide an excellent investment opportunity and have many advantages, and it is not necessarily

true that because restaurants or other franchise units are located there with minority owners that discrimination has been involved, that discrimination explains that. However, one thing the committee should look to if they get additional data that is required by this bill is whether or not there is a pattern between less profitable units and their location in certain areas and the fact that minorities tend to be the owners of those units.

Also, you can look at whether or not the selections are voluntarily taken by the franchisee or are simply assigned by the franchise company. Because oftentimes there may be discrimination in our experience when locations are assigned, it is one of the reasons why the information the bill required would be very helpful. I have made some concluding observations in our statement, but I would, in the interest of time, defer to the other witnesses and I will certainly be available to answer questions, as is Mr. Bendick. Thank you.

Chairman LaFalce. Thank you very, very much.

[Mr. Scanlon's statement may be found in the appendix.]

Chairman LaFalce. Our next witness will be Ms. Jacquelyn Gates, immediate past national president of the National Association of Negro Business and Professional Women's Clubs. Ms. Gates.

TESTIMONY OF JACQUELYN GATES, IMMEDIATE PAST PRESIDENT, NATIONAL ASSOCIATION OF NEGRO BUSINESS AND PROFESSIONAL WOMEN'S CLUBS, INC.

Ms. Gates. Good morning, Mr. Chairman, and members of this distinguished committee. My name is Jacquelyn Gates, and I am the immediate past president of the National Association of Negro Business and Professional Women's Clubs, Inc. I have been a member of the association for 28 years. My career has primarily been in the corporate sector, although I have owned an executive search firm for approximately 2 years in the late 1980's.

Currently, I am the vice president of quality and ethics for the NYNEX Mobile Communications Co. in Orangeburg, New York.

Today I am accompanied by the current national president of NANBPW, Mrs. Catherine Sykes, and our executive director, Ellen Graves. We appreciate the opportunity to share our entrepreneurial experiences and to give examples of how we as an organizational change agent were able to overcome the obstacles that franchisers use to discriminate against women and minorities. For us this opportunity is somewhat emotional because it restores our faith in the system that is wrought with institutional racism, and perhaps right will eventually overcome.

My testimony will give an overview of NANBPW's history and its linkage to economic development, specific examples of the discriminating hurdles we encountered and some recommendations for the future.

NANBPW was founded in the spring of 1935. Our founders were owners, managers, college graduates and other professionally licensed women who had managed to realize some measure of personal success at a time when there was no national movement to improve the lot of black Americans, when there was no black cap-

italism program nor any black studies curricula. Still we were ready to lead.

NANBPW members include 10,000 busy working women in 300 clubs in the United States and Bermuda. We recognize the importance of sharing accomplishments with others and working together, to improve the quality of life in our communities, to create an atmosphere in which black women are able to bring about meaningful changes in our public and private lives, to offer positive role models to the young women in our communities, and now we extend that to all individuals in our communities, and to share our skills and knowledge with others, to explore alternate ways for women to meet the multiple challenges of today's world.

On the local level our 300 clubs identify and act upon the special needs of their respective communities. On the national level we enjoy observer status at the United Nations. We provide a link with other national and international organizations. We cosponsor technical assistance training programs for Government agencies like HUD, the Department of Labor, and others. We facilitate the awarding of scholarships and financial assistance to college-bound students. We conduct leadership training workshops, and we participate in international development programs. We own and operate the Nannie Jenkins Day Care Center in Cuthbert, Georgia.

Historically NANBPW's economic development program thrusts have included the Nannie Jenkins Day Care Center founded 20 plus years ago to provide a safe and reliable child care program for women of this rural town in order that they could become gainfully employed outside of their homes. NANBPW was the first national black female organization to own and operate a Federal credit union, located in Silver Spring, Maryland.

During our 49th national convention held in August 1984, the membership voted to establish the NANBPW Economic Development Corp., which was subsequently incorporated in March 1985. The purpose of the EDC was to expand opportunities available to black women who are substantially unemployed, underemployed, whose income is below Federal poverty guidelines or whose economic and educational opportunities have been limited due to prejudice and discrimination, economic and otherwise, to own, manage, and operate business enterprises. It was founded also to assist minority women in developing entrepreneurial and management skills necessary for the successful operation of business enterprises and to assist minority women in obtaining financial support from other sources.

It was founded to raise the economic education and social levels of minority women, and it was founded to foster and promote interest and concern for the problems of minority women and to foster and promote interest and concern for the problems of minority women to the end that economic and educational opportunities may be expanded and racial tensions, prejudice and discrimination, economic, and otherwise, may be eliminated.

Individual members of our association made financial contributions to initiate the EDC fund. Over $100,000 was collected initially. Members of the EDC board included the NANBPW's president, our first vice president, treasurer and national attorney, and several members from each of our six regional districts, several of whom

were franchisees with McDonald's, Kentucky Fried Chicken, Burger King, and a number of others.

The Howard University Small Business Development Center and the accounting firm of Peat Marwick prepared a comprehensive business plan which outlined the organizational structure, staffing requirements, capital requirements, and proposed business ventures.

American Speedy Printing Centers was identified as a viable franchiser with a special urban program to promote minority ownership of their franchises. The leadership of NANBPW in October 1987 negotiated with American Speedy Printing Centers to serve as a conduit for identifying minority entrepreneurs for ownership of American Speedy Printing Centers franchise opportunities.

In February 1988 NANBPW became the proud owner through its EDC of an American Speedy Printing Center here at 1213 K street in the District of Columbia. The center opened in July 1988, and NANBPW's venture subsequently inspired members to purchase and open individually-owned centers in Detroit, Michigan; Flint, Michigan; Greensboro, North Carolina; and Queens, New York.

In order to grow the business and to provide technical assistance to NANBPW's board of directors, an Economic Development Corp. Advisory Board was established in February 1988. The members included executives from numerous corporations who demonstrated a commitment to minority economic development. The EDC advisory board chairman was Mr. Jim O'Neal, senior vice president of Operations at Frito Lay. Other corporate members represented the Ryder Systems Corp., Boston Bank of Commerce, General Motors, IBM, the Wright Group, and Anheuser-Busch.

American Speedy Corp. was founded upon a marketing plan which focused on a suburban profile. Shortly after their beginning years they realized that the projected high growth arenas were in urban centers, hence, their targeted urban program for minorities. They hired a credible African-American, Andrew Pettress, whose responsibility was to lure potential minority franchisees into the business. His presentations were always dynamic and seemingly sincere. The reality was, however, he had no power, so his promises were usually not fulfilled.

A few examples: He promised that American Speedy would underwrite a 1989 business women's luncheon at the cost of about $5,000 at our national convention in exchange for an exhibit booth to promote its franchise opportunities. The result? The debt was unpaid, yet to date five franchisees joined their system as a result of that exhibit. He promised that the American Speedy Corp. would facilitate the funding process for NANBPW's franchise since it had an arrangement with a very dependable source. Result? The EDC president and myself as national president were required to sign personal promissory notes to fund equipment purchases which left us undercapitalized.

He promised that NANBPW would receive royalties for referred franchisees. Result? Although five franchisees joined the system, only one $2,500 royalty payment was ever paid to NANBPW. He promised gratis external signage in exchange for free nationwide publicity that American Speedy received as a result of its relationship with NANBPW. Result? As of the closing of the business in

1991, signage was never received, which had a negative impact on the business.

He promised comprehensive marketing plans. Result? Marketing promotions were irrelevant to the urban market, especially here in Washington, DC. The absence of a targeted minority marketing plan also forfeited a niche opportunity for NANBPW. He promised that in the event of the business closing American Speedy would assist in the liquidation of equipment. Result? NANBPW was forced to pay large sums to leaseholders when negotiating the equipment returns.

NANBPW is a distinguished women's organization with a long-standing tradition and reputation spanning 58 years. Our legacy is rich with visionary women who dared to go forth into unchartered territory.

To that end, approximately 8 years ago our leadership began a long, methodical search for an outlet for an economic thrust, a natural step fulfilling a multipurpose agenda, addressing education, opportunity, and economic empowerment for our membership.

The search led us to American Speedy Printing Centers. This unique melding of vision and opportunity provided challenge for all concerned. We are all aware that new small businesses fail more than most in the first 5 years of operation. NANBPW's unique business venture is unfortunately among the fatalities.

American Speedy Corp. benefited from its relationship with NANBPW. The publicity from our unique startup, highlighted in over 400 newspapers, numerous national magazines, television reports, and newsletters is publicity that could never have been bought.

Additionally, we brought four additional franchises to the American Speedy table, one which died in less than 6 months and 3 struggling to survive. We know that American Speedy did not value our franchises, and we know that if we were from the suburbs and/or the traditional dominant culture, we would be in business today or we would have been able to sell our business, whether thriving or failing for a profit.

NANBPW values the American enterprise system, but we are committed to an equitable system, and to that end we wholeheartedly, through our 10,000 members, support your proposed franchise legislation as an extension of the affirmative action controls needed to ensure fairness to all. Thank you for this opportunity.

Chairman LaFalce. Thank you very much, Ms. Gates.

[Ms. Gates' statement may be found in the appendix.]

Chairman LaFalce. Our next witness will be Joseph Sánchez, a former minority franchisee. Mr. Sánchez.

TESTIMONY OF JOSEPH E. SÁNCHEZ JR., FORMER FRANCHISEE, MCDONALD'S

Mr. Sánchez. I would like to thank you, Mr. Chairman, and the members of your committee for the opportunity to share with you my experiences as a former minority franchisee of the McDonald's Corp.

For the record, my name is Joseph E. Sánchez, Jr. I am an Hispanic/American. This statement is based upon my experiences as a

franchisee of the McDonald's Corp., from the period of June 1985 through September 1991. During this interval I experienced a series of discriminatory practices initiated and carried out by McDonald's personnel. These abuses and resulting issues are unresolved and are presently being addressed in the Federal court system. This testimony addresses issues which include limited opportunities for minority franchise ownership and expansion within the McDonald's system; steering of minority franchises within McDonald's to low income, depressed, or minority communities while reserving more lucrative locations for nonminority franchisees; discriminatory pricing and leasing policies by McDonald's which impose higher operating costs on minority owners; and the use of arbitrary and discriminatory grading systems and other tactics by McDonald's to limit expansion opportunities for minority owners.

With the committee's permission I would like to summarize my testimony here and submit a full written statement for the record.

Chairman LaFalce. Without objection, so ordered.

Mr. Sánchez. In 1985 I entered the McDonald's system as a franchisee in Houston, Texas. Although originally from the Washington, DC metropolitan area, I was told that the only available opportunities were in the southwest area of the country. I was advised by McDonald's to apply for a franchise in the Houston, Texas, area where my father, Joseph Sánchez, Sr., had been operating a McDonald's franchise since 1978. He, too, had to move from the Washington, DC area because of a purported unavailability of franchise opportunities in the Washington/Baltimore region.

McDonald's initially recruited me to Houston, Texas, with the verbal offer of a brand new restaurant in a relatively affluent suburban neighborhood. When I arrived in Houston, however, this new restaurant suddenly became unavailable because McDonald's corporate representatives said the site would not be good for you. Instead, I was placed in a far less commercially desirable restaurant on an interim 90-day basis until another restaurant became available. This interim period lasted some 15 months and resulted in significant personal financial losses because of the poor restaurant location and physical condition of the facility.

While operating this restaurant I received unwarranted criticism and negative evaluations by McDonald's corporate personnel for allegedly employing too many African-Americans and Hispanics. This was presented to me as being a violation of McDonald's representative work force policy which McDonald's selectively applies to prohibit operators from hiring individuals who do not adequately reflect what McDonald calls the proper racial mix in the community and the restaurant trading area. Despite orders to fire many of my African-American employees, I refused to do so. From that point on my career with McDonald's headed downhill.

After expending considerable money and effort on the interim restaurant, I finally received a more permanent restaurant location in July 1986. In this new location I worked with my employees to excel. Excel we did. We won the outstanding store and outstanding manager awards in two consecutive years, 1987 and 1988. Despite my outstanding performance, I was deemed ineligible to acquire any additional restaurants because McDonald's uses totally

arbitrary criteria to deny an operator more restaurants. In my situation they cited financial problems. They knew that any financial problems that I had were directly attributable to the excessive $15,000 per month rent I was required to pay on the new restaurant. Add to that the substantial renovation costs incurred for the interim restaurant, and it was a no-win situation for me from the start.

Tellingly, the nonminority franchisee who ultimately took over my Houston restaurant received an immediate reduction in rent to $6,000 which, if I had been given the same rent, my financial problems would have been nonexistent.

My attempts to work out my problems with the local McDonald's personnel proved unsuccessful, and I soon began encountering various forms of racially offensive treatment within the region. Following are a few such instances: I was told that Hispanics lacked the intellectual capability to contribute to the local marketing cooperative board, my bilingual management personnel——

Mrs. MEYERS. Mr. Chairman? By whom?

Mr. SÁNCHEZ. By whom? There was in—the co-op itself is a body that is organized for the purposes of marketing in the region. The members are operators and also regional representatives.

Mrs. MEYERS. Well, Mr. Chairman——

Mr. SÁNCHEZ. Corporate regional representatives.

Mrs. MEYERS. We reviewed the testimony by Mr. Sánchez, and it seemed to us that there were some things that he was saying that were undocumented and defamatory, and we asked him to withdraw his testimony.

Chairman LAFALCE. There should be no censorship by this committee at any point in time of any individual. If you were asked to rewrite your testimony to suit any particular Member, it is my instruction to you to totally disregard that and speak your mind.

Mrs. MEYERS. Mr. Chairman——

Chairman LAFALCE. We shall not engage in censorship. The witness will please proceed.

Mrs. MEYERS. Mr. Chairman.

Chairman LAFALCE. Regular order, Mrs. Meyers.

Mrs. MEYERS. I think that, if you are going to defame people, I think you should close the meeting. I am not trying to censor his remarks. I am simply saying I think it is inappropriate that people can say anything they want to about a business totally undocumented and in an open meeting.

Mr. SÁNCHEZ. Mr. Chairman, I have witnesses that were in that meeting that have given deposition testimony to the effect that derogatory statements were made.

Chairman LAFALCE. Please continue.

Mr. SÁNCHEZ. Thank you, Mr. Chairman. My bilingual management personnel were refused entry into local McDonald's training programs because of their accents, nonminority franchisees who entered the system and the Houston region at the same time as I received additional restaurants and received various forms and special financial assistance such as low or no interest loans for capital improvements and special low rent structures that were denied me.

As a result of McDonald's refusal to let me expand and the many forms of racially directed abuse I was experiencing from McDon-

ald's, I had to get out of Houston. I think the committee should know that when I went to Houston in 1985 I was the third Hispanic franchisee with a total of only five Hispanic-owned restaurants in the Houston metropolitan area. Today 8 years later there still is only three Hispanic franchisees and one of those will be leaving McDonald's at the end of July, leaving a total of merely six Hispanic-owned franchises.

I cite these statistics because the same metropolitan area has over 140 McDonald's restaurants owned by more than 40 franchisees. The 1990 U.S. census data demonstrated that the Hispanic population of Houston exceeds 25 percent, enough to require a new Hispanic congressional District. McDonald's has not welcomed Hispanics or Hispanic-franchises in Houston.

In the summer of 1989 I received an opportunity to purchase a McDonald's restaurant in the area of Baltimore, Maryland, called Park Heights/Pimlico. Although I was told by McDonald's personnel that there was only one restaurant available at the time, I was also assured verbally that I would receive a second nearby restaurant planned for construction when it was finished. After I was in the restaurant for about a year I was advised by McDonald's personnel that I had been offered the Park Heights/Pimlico restaurant only because I was a minority. I subsequently learned from a McDonald's Baltimore personnel executive who was forced to resign under adverse financial terms for trying to solve my problems with McDonald's that McDonald's had, in fact, misrepresented the facts about available restaurants in the Baltimore area at the time I was trying to move there. It turns out that there were other Baltimore area restaurants available for sale in the general time period I sought to relocate, but they were in white suburban areas and reserved for white operators.

It was only on the basis of the McDonald's assurance of the second restaurant and future cash-flow assertions provided by McDonald's that I agreed to purchase the restaurant in Baltimore. My transfer to Baltimore was initially promised by a McDonald's corporate officer to be an even exchange of assets from Houston to Baltimore. At the 11th hour I was told that I would be required to pay an additional $200,000 for the Baltimore restaurant because of a projected greater sales than the Houston restaurant. Further, I was told via a tape recorded voice mail message from McDonald's that, one, I had to find a buyer for my Houston restaurant before I could even be considered for the Baltimore restaurants, contrary to the even exchange that I had been assured and; second, in that tape recorded message on the apparent basis of neighborhood trading area racial demographics I could only sell my restaurant to an Anglo, to a Hispanic, but certainly not to a black.

McDonald's then sent two potential nonAfrican-American buyers to see me. These buyers, however, indicated that they would not pay the price for the Houston restaurant which had been established by McDonald, not by me. I was not permitted to negotiate a sale price. My father then called the McDonald's to inquire about purchasing the restaurant, and he was flatly refused. I made a copy of the recorded voice mail message that was received on McDonald's communication system and sent it to the powers that be in Oak Brook, Illinois, the corporate headquarters. I was assured

by the McDonald's corporate officer that the matter would be investigated. This investigation never occurred. The overriding concern of the McDonald's corporate officer seemed not with addressing the underlying racism implications of the voice mail message, but instead with cover up of the incident since he wanted to know specifically who else knew about the contents of the voice mail message.

After my conversation with the McDonald's corporate officer, I received a call from a McDonald's corporate staff director for affirmative action who acknowledged the Houston region's discriminatory practices against Hispanic operators by commenting that "you have to know how to operate in this white man's company."

In the meantime, I was unable to find a suitable buyer for my Houston restaurant and was forced into exchanging it for the Baltimore restaurant to keep from losing the latter. As a condition for the exchange, McDonald's required me to borrow several hundred thousand dollars, $200,000 of which was an additional payment for the Baltimore restaurant because of misrepresented higher cashflow and the alleged resulting value increase.

After moving to Baltimore I was assured immediately by the local McDonald's personnel that I would be awarded my soon-to-be-built restaurant. Shortly thereafter McDonald's local and corporate personnel officials told me that I had to maintain a 100 percent African-American work force because the Park Heights/Pimlico neighborhood demographics were purported by McDonald's to be 100 percent African American. I was told that if I didn't follow this direction and if sales decreased as a result of my employment practices that McDonald's would come in the restaurant and straighten things up. Needless to say I objected because this would have required me to terminate my few nonAfrican-American employees, including some Hispanic individuals I had brought with me from Houston.

For the record, my work force at the restaurant at the time was over 90 percent African-American. Later, I attended a Baltimore City minimarket meeting of McDonald's franchisees operating restaurants within the city boundaries, where I actively sought increased advertising emphasis directed to our community customer base. After this meeting, which was attended by McDonald's personnel, I was warned by McDonald's not to cause trouble by trying to market too aggressively to the inner city customers and by associating with the African-American McDonald's franchisees in Baltimore.

Within 4 months of arriving in the Baltimore region I was told by McDonald's to hire and begin training staff for my soon-to-be-built restaurant. I promptly responded by investing in hiring and training staff on the reliance of the direction. In June 1990 when I was driving by the site of the new restaurant, I observed that construction activity had commenced. I immediately called McDonald's and asked why I had not been consulted. The McDonald's representative did not respond but had the regional personnel manager call and tell me that the new restaurant was going to be a McDonald's Corporation-operated restaurant. The regional personnel manager told me I shouldn't complain because Hispanics in McDonald's had to be subservient to succeed.

During my 18 months in Park Heights/Pimlico area, my restaurant was robbed numerous times. Drug use and abuse in and around the restaurant forced me to employ special restaurant security to deal with the problem. Vandalism and destruction of the restaurant's physical premises and furnishings occurred so frequently that I could not keep track of all the incidents. Ironically when I was trying to decide to move to Baltimore, McDonald's corporate personnel indicated that the restaurant had little if any crime problem, and I had no reason to doubt this at the time since I was not from the area.

I also learned that McDonald's corporate personnel were advising all regional accounting personnel that the figures in McDonald's pro forma projections used to calculate restaurant value and future cash-flow were not accurate. The reliability of the financial data supplied by McDonald's representatives and relied upon by me and my bank to purchase the Park Heights/Pimlico restaurant therefore appears to be unwarranted. In December 1990 I and my wife, Kathy, met with McDonald's, and it was at this meeting that we learned for the first time about the franchise's prior history of employee and customer drug problems plus crew theft plaguing the restaurant prior to my purchase. It was actually referred to within the regional McDonald's office as the "O.K. Corral."

We then met McDonald's to discuss all the promises that had been made and subsequently broken. To our shock the McDonald's representative indicated he was totally ignorant of all the prior problems at the restaurant. When my wife complained to the McDonald's representative that she was unable to work in the restaurant because of the extremely violent criminal activity, the McDonald's representative told my wife that if he had known the color of her hair (my wife is blond and fair-skinned) he would never have placed me in that restaurant.

Further, the McDonald's representative said that if there was an Hispanic neighborhood in Baltimore, he would have placed me there, but since there weren't any, he stated I was placed in Park Heights/Pimlico restaurant solely on the basis of my minority status.

Our last meeting with McDonald's Baltimore regional personnel took place in January 1991. I again was joined by my wife and during that meeting a McDonald's representative made the statement that as a white man I felt very uncomfortable in your store. The McDonald's representative again stated that I had to be put into a white restaurant. Let me make clear to this committee that I strongly objected then and I strongly object now to the view that franchises be awarded to anyone strictly on the basis of racial criteria even though I believe in the need for aggressive affirmative action where this is necessary to correct past discriminatory franchisor actions.

My point here is that I found McDonald's whole approach to awarding me or anyone else a franchise on the basis of my racial and ethnic background, my surname or my wife's hair color to be totally offensive.

I eventually had no choice but to file a lawsuit in the Federal court system in July 1991 and voluntarily left McDonald's in September 1991 after years of subtle and overt ethnic abuse.

Why hasn't there been a ground swell of complaints from the McDonald's minority-operated community? The answer is very simply fear; fear of retaliation, fear of losing their businesses, fear of losing everything that they have worked for. What I considered to be designed and calculated indentured servitude, McDonald's has placed a substantial number of minority operators in the position of being both a franchisee and a borrower. Poor locations, with high operating costs and low profits have forced minority operators to seek financial help from the lender of last resort, which is McDonald's.

Contrary to what McDonald's management calls a partnership, this biased business relationship by its very nature limits any and all forms of protest, complaint, and criticism. If protest is attempted by anyone within the minority operator community, swift financial retaliation is the response from McDonald's, who is both the franchisor and lender. Additionally, minority operators are coerced into their silence or false system support with the promises of additional restaurants or financial inducements. Further, minority operators and McDonald's former minority employees are forced to sign release agreements strictly prohibiting them from pursuing any form of legal action to redress claimed Federal civil rights violations by McDonald's.

Mr. Chairman, you may hear that the testimony I give to you and the committee this morning is nonrepresentative and that it only depicts isolated problems experienced by a disgruntled former licensee. In fact, my views are shared by other Hispanic operators who are still within the McDonald's system. A summary of concerns was formulated during a meeting by the governing body of the McDonald and Hispanic Owners Association. This board of regional spokespersons represented the views of over 115 Hispanic operators. These concerns were documented and are attached herewith.

A representative sample of the concerns raised by this board which addressed McDonald's racially biased practices are as follows: Regional managers abuse: There is no respect, red lining of Hispanic owner/operators, not having equal access to all areas, lack of store expansion by existing owner/operators, lack of upward mobility in McDonald's operated restaurants for Hispanic employees, there is a question concerning the status of a Hispanic advocate in Oak Brook. Nobody knew who it was and who would it be in the future. New Hispanic owner/operators were placed in markets with limited growth potential. There was double standards in multiple store awards and financing. McDonald's was cherry picking stores. There was a lack of equality and fairness. Oak Brook had preferential treatment on store sales. There was retribution for past conflicts with regions or regional managers, and there was a lack of parity in the McDonald's system for Hispanic employees-entry level jobs, sponsors, mentors, et cetera.

Mr. Chairman, as you can see in the foregoing, the abuses I have raised this morning aren't a fabrication of one disgruntled former minority licensee. The problems are real and in response to McDonald's corporate statement that its relationship with its franchisees is the best in the industry, they must be addressed and resolved.

New legislation for equality and fairness in franchising is needed. Legislation addressing these issues must include requirements for franchisers to make full and complete disclosure to prospective franchisees regarding sales history, previous restaurant ownership, projected sales impacts of any planned units in the surrounding market trading area, sales projections for the franchise locations, and other pertinent facts which could affect the restaurant's sales activity and value. Also, as Mr. Robinson indicated earlier this morning, there should be a prohibition against unfair trade practices in franchising, such as churning, bait and switch tactics, and price and rent discrimination.

In closing, Mr. Chairman, I would like to again thank you and the members of the committee for extending an invitation to me to speak before you on the issue of discrimination which does exist in minority franchising. I wish you success in your legislative endeavor.

Chairman LaFalce. I thank you very much, Mr. Sánchez.

[Mr. Sánchez' statement may be found in the appendix.]

Chairman LaFalce. Our next witness is Mr. Nitin Shah, chairman of the Asian American Hotel Owners Association and also a member of the executive committee for the American Franchisee Association. Mr. Shah.

TESTIMONY OF NITIN SHAH, PRESIDENT, ASIAN AMERICAN HOTEL OWNERS ASSOCIATION

Mr. Shah. Mr. Chairman, members of the committee, my name is Nitin Shah. As you mentioned, I am a franchisee of several hotel branches. I am also the Chairman of Asian-American Hotel Owners Association and a member of the AFA, which is American Franchisee Association. It is indeed my privilege to address this House Committee on Small Business hearing entitled, "Minority franchising: Is discrimination a factor?"

After a brief description of what these two associations are and do, I will get to the key issues identified in this hearing. I will comment on vital issues and problems that minorities face before and after purchasing and operating a franchise. I will also comment on other issues relating to franchising that affect all franchisees.

Finally, I will make recommendations as to the actions the committee might take to ensure fair and equitable franchising.

The Asian-American Hotel Owners Association is a nonprofit organization. It was established in 1990 primarily to address the issues of discrimination, institutional bias, stereotypes, and stigma that many Asian hotel and motel owners faced in the hotel industry, especially from franchisers, lenders, travel organizations that grade hotels, vendors, and insurance companies that affect the economic viability and some time the very survival of the many Asian hotel and motel owners and operators.

As of today we represent approximately 1,500 hotel owners owning almost 7,500 small- and medium-size motels, including franchised and independent. While we have made many strides in areas of discrimination and other issues through this organization, a lot remains to be done.

Recognizing that all minorities face similar obstacles and problems that we face in the hotel industry and are prevalent in all franchised businesses, and after realizing that the franchisers are too strong, individually and collectively, to force any change singlehandedly, our association decided to become a founding member of the American Franchisee Association.

The AFA was founded earlier this year to represent and address problems facing franchisees in all industries in the development of franchising and its fair regulation by the Government, educating franchisees, potential franchisees, the Government and public as to the needs and issues facing franchisees, protecting improving, and enhancing the business conditions and economic investments of franchises.

As of today, the AFA represents 10,399 franchised outlets owned by over 5,200 franchisees in 14 different industries.

Now, in keeping with the issues identified in this hearing, the following are some of the issues that we think pose a major challenge to us as a minority franchisee: First, difficult access to minorities in many franchise systems. Several prominent franchisers work hard to help minorities in becoming franchisees and with promoting equal access to their system to them. However, there are other franchisers who once they find out that the applicant is an Asian or other minority, they either deny or make it extremely difficult to obtain their franchise for a particular site or location.

How do they deny or make it difficult to get a franchise? The reason given for the denials vary depending on the situation, but the following reasons are the most commonly used: One, your financial standing is not adequate; two, you do not have management or franchise operations experience; three, you do not have established credit; Four, your location is not our target market; and five, you do not meet our franchising criteria.

Consequently, it is extremely difficult, if not impossible, to prove that your application was denied on the grounds of bias or discrimination or for the reasons other than stated.

Often they impose rigorous requirements or process an application so slowly that either the minority applicant loses interest or he or she loses their financing or location commitment. In many cases they would not accommodate or make certain exceptions to their requirements which they might make for other franchisees.

I do want to emphasize that if traced, a double standard can be seen. A minority applicant has to go through an excruciating process that other applicants do not have to endure to get a franchise application approved.

For example, you might be interviewed by 5 to 10 department heads before you are approved or they may ask you to put a large deposit in escrow for future royalty payments, thus changing the financial burden for minorities.

Due to their reluctant approval, a minority franchisee loses any or all chances to negotiate for a fair agreement and terms. After purchasing the franchise, there always remains a constant fear of reprisals and retaliation—what will the franchisor do—which can put a fatal blow to the economic viability of the business.

Second, inconsistent selection criteria for a new franchise. When it comes to minorities, many franchisers apply different and incon-

sistent criteria for the selection of a franchisee, especially when two or more applications are received for the same location. While it is always difficult to prove it, there is a feeling in the minority community that, if given a choice, they are the last ones to be chosen to get the franchise.

On a good site selected by a minority franchisee, a franchisor encourages sometimes other franchisees in the area to apply for the franchise and then deny it to the minority by stating that the existing franchisee has a pending application or has the first right of refusal. Thus, locations that minorities generally get are secondary locations where someone else has already failed or in the inner-cities or towns where no one else wants a franchise.

Third, arbitrary and biased application of impact or encroachment policies. Few franchisers have written impact or encroachment policies, even though they are the most controversial issues facing all franchisees. These impact policies are applied arbitrarily and inconsistently, especially when it comes to the minority franchisee.

Many franchisers work with superior knowledge. They know about the limited resources, knowledge and ability of existing minority franchisees to fight an encroaching application for a new outlet. The result is often the approval of franchises of preferred applicants in close proximity of a minority-owned franchise outlet. The franchisers also know that many minority franchisees lack financial resources and wherewithal to fight the protracted legal battle required to win an impact issue. If one does fight the franchisers, salaried legal staff can harass and fight the minority franchisee to the point that they give up and that, of course, is the franchisor's goal.

Franchisors run their own complicated, sophisticated market analyses studies prior to putting up any new outlet. They know if the new construction will impact existing outlets by X percentage or if the proposed new unit will impact by X percentage. Franchisers are not telling the whole truth when they say that you are not impacted or that you cannot prove impact. There is a feeling in the minority community that the reverse is not often true. For example, when and if the same applications were made by minority applicants with the existing encroached franchisee not being a minority, then the minority applications would be rejected or not treated fairly or equally. Because there are so many factors involved when determining an impact issue, it is extremely difficult for a franchisee to prove such claims without almost spending limitless financial resources.

Franchisors further claim that impact is an equal qualitative analysis. They claim there are ways that they can show or prove that the impact caused to an existing franchisee can be measured in percentages as close as 3 percent of the revenue. Afterwards, if your revenues are reduced by less than 3 percent, they consider it does not impact the existing franchisee. We disagree with this because in any impact, regardless of whether it is 3 percent or less or more than 3 percent, it is an impact. The margin of error in any statistical study is 3 to 5 percent. How can one judge the impact of 3 to 5 percent of, say, a million-dollar revenue?

Difficult transfer of an existing franchise. In many circumstances when a minority purchases an existing franchise, the franchisor often imposes tougher standards of quality assurance or renovation, higher royalty fees, higher transfer and other fees to the minority applicant. In most circumstances, the franchisor will not let you assume an existing franchise agreement. Instead, they will make the buyer sign a then current franchise agreement which is more stringent and often more expensive.

The seller cannot get out of the existing franchise agreement without paying large liquidated and other damages, and the minority business has no choice if he wants to purchase the business. The minority franchisee has no alternative but to accept all the new terms and conditions of the franchisor or lose the deal.

In many instances the franchisor knows that the lender of a prospective buyer will condition the financing on the continuance of the franchise and that buyer has no other choice but to accept the franchise with whatever conditions the franchisor may impose. In many cases the franchisor sees the transfer as an opportunity to exercise extraordinary rights.

For example, in the hotel business, if you sell your franchised hotel, most of the franchisers require a product improvement plan to extensively renovate your property regardless of whether it is needed at the time or not. However, this means the new buyer must expend large sums of money to completely renovate the property. At times, funds for such renovations are required to be put into an escrow account. This product improvement plan would not ordinarily be imposed on the seller if he does not sell the property, meaning it is not really needed. As you can see, the standards vary drastically for the minority applicant.

Issue number five. Financing conditioned upon obtaining a franchise. It is a well known fact that the minorities have a difficult time accessing capital. This is especially true when you are a new entrant or a first-time buyer of a business. Lack of capital or limited capital hampers the ability of minorities to start or purchase a business. However, in many instances when a minority who has obtained the financing and wants to purchase an independent nonfranchised business, the financing is conditioned upon obtaining a franchise. Many SBA lenders insist that you obtain a franchise. Hence, the prospective business owner has no choice but to seek a franchise. Often this means he or she must choose whatever franchise is available regardless of cost, terms, and conditions the franchisor may impose or risk losing the financing and therefore risk losing an opportunity to acquire a business.

Monopoly on fees, terms, and territorial rights. In many instances the franchisor knows that your financing commitment is contingent upon obtaining a franchise and theirs is the only one available in the area that the lender will accept. The franchisor then has no incentive to negotiate fees, terms or conditions of the franchise. Consequently, they impose stringent conditions, less or no area of protection, higher fees, et cetera.

Other issues that affect all franchisees and not just the minorities. Having mentioned what are the main issues facing minority franchisees, I would like to mention other extremely vital issues that all franchisees face but severely impact minority franchisees

in particular because oftentimes they lack basic education, understanding, and legal implications of franchising. Many times, even when they understand the implications, they lack the resources to fight because of the financial limitation and for the fear of being blacklisted by the franchisor.

These issues are as follows: Territorial protection impact encroachment. Same brand name impact and or encroachment. Mr. Chairman, the most fundamental premises on which the franchising concept was born was to have a certain territorial and market protection to every franchisee in the given market in exchange for the franchisee paying regular royalty fees. It used to be when a franchisor would guarantee in writing in the franchise agreements such protections. However——

Chairman LaFalce. Mr. Shah, I don't want to constrain you. On the other hand, we have some time constraints. I am wondering if it would be possible for you to summarize your remarks and move fairly swiftly.

Mr. Shah. OK. Mr. Chairman, this area of encroachment and impact is such an important issue to all franchises and all the industries that I would like to say that impact studies are done in a qualitative, arbitrarily subjective way. A fundamental tenet of franchising is violated when protection of the territory is not given, and if it is given in certain areas, it is almost limited to a street block or sometimes to unreasonably small distances where there is really no chance of other franchisers coming anyway. Many franchisees have circumvented the issue of impact by creating this other brand under the disguise of what they call market segmentation. That means they will issue another franchise name with small changes in trade and locals and brand names and put it right across the street from your existing brand. That effectively really is an impact issue, but they consider it is a different market, different segmentations, and have very little product differentiation, so it is, in fact, circumventing that you don't really need to worry about impact because it is a different brand, but to a consumer the logo looks almost the same or it disguises them, whether it is the same or not, so that is another way they are circumventing the impact issue.

Another issue that I just want to say very briefly is many franchisor mandates in their franchise agreement that you buy supplies, equipment, signs, et cetera from only so many vendors, and in some remote location in small towns in areas there is only one approved vendor, so effectively you have no price control, no way to negotiate the kind of service they would provide. Sometimes they come once a week, once a month to service your area. You don't see something, but you have no choice but to buy it from them.

Example, in my hotel business, we used to buy a lot of soaps which is $48 per case that I could buy locally for $38 a case, which means thousands of dollars for my business, but all these businesses are not approved because they have initially approved one vendor that is thousands of miles away from you, so you basically are demanded to buy at whatever price as long as they would give it. We understand the specification, we like to abide by the high quality standards, but there is no reason we see that they need to

mit supplies to approved vendors only if the others can meet the pecific issuing criteria.

I just want to finally say in my closing statement that a compre-ensive legislation is long overdue to make the franchising busi-ess such that it is equally accessible to everybody. The selection riteria should be the same and consistently applied. All fran-hisers are treated equally when issue of impact or encroachment rise, reasonable territorial protection should be given to every-ody, and all the terms and conditions of impact on any other issue hould be mentioned in the franchise agreement as the terms and ondition not subjected to change like they are now.

Thank you.

Chairman LaFalce. Thank you very much, Mr. Shah.

[Mr. Shah's statement may be found in the appendix.]

Chairman LaFalce. Our next and last witness will be Mrs. Patri-ia Grant.

ESTIMONY OF PATRICIA A. GRANT, FORMER FRANCHISEE, HAIR PERFORMERS; ACCOMPANIED BY NATHANIEL GRANT

Ms. Grant. Mr. Chairman and members of the committee, I ould like to thank you for the opportunity to share our experi-nces in the purchase and operation of a national franchise, specifi-ally Hair Performers as minorities. My husband, Nathaniel Grant, ho is present today, who may be assisting me with this testimony, e were the owners of a Hair Performers franchise. Also I would ke to recognize there are several other ex-Hair Performers owners ere as well as Wee Care owners here who also have experienced imilar support issues that I will be outlining in my testimony.

I will be summarizing some aspects of the testimony and I would ke to submit the full written testimony for the record.

Chairman LaFalce. Without objection, so ordered.

Ms. Grant. We have talked today about many reasons why eople buy franchises. Franchises have been touted as a logical ath for entrepreneurs, individuals that have reached the top of heir career path, those that have been laid off, have money to nvest, et cetera. People are getting home equity loans, small busi-ess loans, as well as using their severance and lump sum pay-nents to get on the bandwagon. Magazine articles have been writ-en stressing the success rate of franchises. There are franchises or everything from shoeshine parlors to whatever your heart de-ires.

Let the buyer beware. We need to avoid sophisticated scams. In he State of Maryland there were five existing Hair Performers at he time of our salon's opening. Two closed; that is, went bankrupt ithin 6 months of their opening, and the others closed within 1 to ess than 2 years after opening. Most of the salons outside of Chica-o, which was the headquarters of Hair Performers, experienced roblems which have resulted in their closure or not being run as a Hair Performers franchise.

Minority franchises in Pennsylvania, New Jersey, and California ave all closed. There are numerous nonminority salons that also ave gone bankrupt or where the owners have had to walk away rom the business or sell them at a considerable loss. I would like

to depict somewhat of a reality for the beauty industry. The beauty industry is still a somewhat segregated industry, which as a normal mode of operation black clients are serviced by black hairstylists and barbers, white clients are serviced by white hairstylists and barbers. Black hairstylists and barbers mainly work in black salons and vice versa for white hairstylists and barbers, and there are products for black hair and there are products for white hair.

The beauty industry is also a regulated industry. The laws and regulation vary from State to State. As a result, a franchisor should and must be capable of understanding these norms and regulations and incorporate them into their methodology.

Our attraction to purchasing a Hair Performance franchise was based on three things. One, John Amico assured us that we could support our operation as a minority black salon, John Amico carried an ethnic line, Tonite, and our not being hairstylists would not hamper our ability to be successful. My husband and I formed a corporation called Grant and Grant Enterprises in August 1988 for the purpose of purchasing and operating it as a Hair Performers franchise for a fee of $15,000.

I also want to note that one Wee Care owner also paid $15,000 for their franchise. Some owners have paid fees and have not opened. The John F. Amico Co. provided assistance in the selection of the location of our beauty salon to a moderately low income area of Prince George's County. The total cost associated with opening our business amounted to a total of over $148,000. Loans can be an advantage or a disadvantage.

We had two loans which were secured with monthly payments of $1,800 and $1,200. The advertising program benefited the Hair Performers Salons in the Chicago area. There were no radio spots in the Maryland area and the grand opening print ads, which we paid $6,000 to Hair Performers were placed in area mailers for only the first month of operation. We spent an additional $1,500 of our own money in print ads in an attempt to increase business. Each franchise in our area was responsible, not only in our area but basically all over, responsible for implementing its own advertising program. There was no group advertising program which would have reduced costs.

Compensation schedule. We tried two compensation schedules proposed by Hair Performers. One was an hourly salary plus commissions based on an escalating compensation schedule. The second schedule was based on an escalating compensation schedule plus a service fee. We started to lose money rapidly with the compensation schedule that incorporated an hourly fee due to the fact that we were paying hairstylists to sit when there were no customers; that is, we didn't have any income coming in, but we still had to produce a payroll.

The second schedule caused major havoc with our hairstylists as a result of the service fee that was incorporated. This was not a tested compensation schedule in the Maryland area and was definitely a major reason for the massive staff turnovers in our salon since the schedule was not competitive nor the norm. Due to the massive staff turnovers and impossibility to attract new employees due to the compensation schedule, we had to contribute an additional $21,000 from other lines of credit to keep the business alive.

We decided on our own in 1991 to bring our operations more in line with other minority salons in the area to be more competitive. We changed our commission structure to 50 percent for the hairstylist and 50 percent for the salon. The 50 percent for the salon was to cover the loan payments, rent, purchase of supplies, FICA contribution, insurance payment, utilities; that is telephone, gas, electric and water, operating pass-throughs, advertisement and other operating expenses. The cost of the loans were overwhelming and the payroll taxes, unemployment taxes, property taxes, and insurance payments continued to cause additional indebtedness using open lines of credit.

After we had gotten so far behind in paying our royalty fee, Hair Performers did provide $350 in advertising assistance which had little or no impact. They still held us to paying our royalties. We then decided that the Hair Performers system was not working. In January 1992 we changed to independent contractors who paid a weekly fee for the use of their chair and salon facilities. This change greatly reduced our payroll tax liabilities and salon operating costs.

In September 1992 John Amico filed for bankruptcy selling the Hair Performers franchises to a company based in Chicago, Kelsey Co. We received mailings for the new ownership and requests to pay royalties. There was no mention of any other services to be afforded to our business. The Kelsey Co. later sold the franchise rights to barber salons located in Minnesota. I would like to give a synopsis of our specific minority issues.

Location. Location is critical to any business' success. Another beauty salon is located in our same shopping center. When we first started out, we were running as a commissioned salon, and running a commissioned salon with another salon in the same shopping center servicing the same type of clientele was a problem. Our area is saturated with other minority salons. We were told by Hair Performers to not worry because its proven system would outperform this other salon. There are over seven salons within a 2-mile radius which also service the same type of clientele.

We constantly had to have sales in order to attract customers. Most of our sales were relaxer sales which necessitated high supply costs with reduced income.

Equipment purchases. Work stations. The work stations that we purchased from Hair Performers were not functional for black hairstylists. We had to come up with a solution on how to remedy this situation on our own. This resulted in an extra unforeseen expense to customize the stations to make them more usable by our hairstylists. Hair Performers should have foreseen this problem since they knew our salon would be a minority black salon.

Hair dryers. Now, it may be trivial to you, but it is important. Our hairstylists and customers have complained since day one that the dryers that we purchased from Hair Performers take too long to dry hair. This may be directly related to ethnic hair and the styles that black clientele get versus white clientele. We have, as a result, had to purchase additional dryers to compensate for this problem. Another extra and unforeseen expense.

Products. We felt it was important to purchase John Amico's ethnic line, Tonite. However, we soon learned that the product cost

more, shipping costs were too high, this is a common issue with most owners, and the product did not process the hair as fast as other ethnic lines which were less expensive and more available through local distributors. I would like to give an example of what I mean by that.

For example, the 16-ounce Tonite relaxer costs $6.25 versus other ethnic lines ranged anywhere from $3.99 to $5.50. Tonite relaxers and curls only came in 16-ounce containers which was not cost-effective since other ethnic lines could be purchased in larger containers, 4 pounds, thus offering better cost saving and usage. For example, we could purchase another ethnic product for $14.95 for a 4-pound size versus $25 for four 16-ounce containers of Tonite.

We used a lot of Tonite since Hair Performers encouraged us to use it since it could not be purchased by other salons, therefore requiring clients to come back to our salon. We bought into this marketing philosophy, even though, one, our hairstylists constantly complained that the product was not efficient and the product was costly. Being that my husband and I are not hairstylists, knowledge of ethnic hair, training and fill-in assistance was important from the franchisor. The trainer who provided grand opening training was not familiar with the Tonite line and could not offer any pointers.

Of the three local regional directors, two did not have licenses to operate in the State of Maryland and none of them were able to offer any assistance or pointers to our staff. Not having expertise with minority hair or licenses made them unable to provide roll-up-the-sleeves service when we did not have hairstylists to provide service or hairstylists present to provide that service. Therefore, their visits to our salon were basically social.

My husband and I, as owners of Grant and Grant Enterprises hope that the final outcome of this committee is to make it possible for franchisees who have been subjected to discriminatory conduct and left to operate without support from the franchisor be released from binding franchise agreements and have their franchise fee refunded.

In addition, I would like to point out some things important for prospective franchisees to know. Franchises, in most cases, are in favor of the franchisor. The contract gives the franchisor the rights to everything. For example, no lawsuit, only arbitration. Arbitration may be good, I don't know, but I can cite a recent complaint which was tried via arbitration, an ex-Hair Performers lawyer was one of the members of the arbitration board. I don't know whether this was a conflict of interest or not. It certainly was a no-win situation for those owners.

If and when you can sell, if the business goes sour or otherwise, and if the franchisor goes bankrupt as in the case of Hair Performers, John Amico, the franchisee has no say in who the successor and no option as to whether you can depart from the system.

If the franchisor goes bankrupt, the company that represents the franchisor should not be allowed to start up a similar franchise under a different name. John Amico, who owned Hair Performers prior to his going bankrupt, has started up Wee Care Hair, proposed as a smaller scale beauty salon built on similar methodology as Hair Performers. One Wee Care Hair Salon in Maryland has

changed its name and operations while another in Maryland is experiencing similar support issues as Hair Performers. There appears to be the same pattern of issues for the Wee Care hair franchisees that occurred with the Hair Performers franchisees.

A franchise that is not known in your area may not be beneficial to a prospective franchisee since there is no name recognition, especially if the franchisor has not done an adequate job in testing the market prior to opening it up for sales. If the franchise is not a known entity, it has no added value. In addition to information on the number of sales, there should be documented information on problems in and outside of the franchisor's headquarters. Prospective franchisees should be leery of being the guinea pig. The franchisor should establish name recognition in a new area first either by opening up several company stores or some other method.

Franchise source are driven by royalties and basically that is all they want. You pay and generally get nothing in return. When our business, as was the case with fellow franchise owners, was having trouble, the franchisor insisted that we pay our royalties, even though we could not pay the rent, make loan payments or pay our own personal bills. Our other creditors were more understanding or willing to work out a solution.

There should be controls implemented and limits imposed over the amount of up-front moneys that a franchise owner should be required to put up. In most cases the reason why so many franchisees fail is because they ran out of money early in the operation but not out of debt.

The prospectus is just a marketing tool. It should include items to assist the prospective franchisee in making a good business decision, the profit and loss statement of the franchisor, how many franchises have failed due to bankruptcy or otherwise, not just information on the number of sales, how many failed franchises are turned over to the franchisor and in what period of time, is the franchisor the original founder or the successor, and if the successor, the successor should provide background information.

The Federal Trade Commission and State agencies need to investigate why so many franchises fail, especially by a specific franchisor. Most of the franchises in Maryland failed in less than 2 years, and two failed in less than 6 months. A Hair Performers franchise costs $15,000 and is for 10 years. A typical building lease is for 5 years. Loans are from 5 to 10 years. If your franchise fails, your franchise fee which you have paid for in advance should be refunded.

Language should be included in the franchise agreement which holds the franchisor more accountable to the success of its franchise owners. Currently, a franchisor is permitted to include language that excludes them from guaranteeing the success of its franchisees. It should be an equitable agreement. Prospective franchisees need to be leery of the type of support franchise source say they will provide. Prospective franchisees need to ask what will franchise source do to assist in the franchise's success, that is, when the going gets tough, and it does, does the franchisor provide assistance or support.

The basic underlying points here are you can do bad by yourself, and what I mean by that is one can go into business on his or her

own and avoid headaches of paying royalties and getting nothing in return, paying out more startup costs because the franchisor requires your business to look like the other franchises when it really could be done for less and by doing it on your own, you are more proud to own your business and not feel frustrated and ridiculous for having paid a lot of money to belong to a franchise system that made you fail.

I would like to acknowledge some of the, if I have time, comments by ex-Hair Performers and Wee Care Hair owners. I am just going to summarize their statements. The Hair Performers in Germantown, which is closed and Washington, DC, which is not operating as a Hair Performers, Ellen Mackey, the owner, she paid for three franchises. Two were open and after she saw what was going on, she thought it not best to go ahead. She never got her money back for the one that was opened. She lost about $200,000 for her businesses. A Wee Care Hair that is still in existence, currently open, the lease is too high, this is minority franchise owner, for your information. At the prices we had, the volume of people have to be high every day. Weather can cause low amounts of clients. They were told that they needed $6,000 for working capital. They were told to continue with the construction, and they said we will have gone into our working capital. Then they said it is all right, you don't need working capital. They have been paying franchise fees since they opened and never got support from them at all.

Thank you for this opportunity to speak before your committee, and I wish you well in providing some legislation that will assist us in the franchise industry.

[Mr. and Mrs. Grant's statement may be found in the appendix.]

Chairman LaFalce. Thank you very much, Ms. Grant.

We will now go to the question and answer period. I will defer questioning and go to Mr. Mfume.

Mr. Mfume. Thank you very much, Mr. Chairman. It is almost like living a nightmare hearing some of this testimony, and I can only say that it is distressing at the very, very least. I know I have a very limited amount of time, and so it is going to be difficult. What I may want to do, Mr. Chairman, is to submit additional questions for the record.

Chairman LaFalce. Surely.

Mr. Mfume. I began my brief remarks this morning by suggesting that the franchisor-franchisee relationship was, in fact, for all intents and purposes a master/slave relationship. I think clearly after the testimony that I have heard today and much of the testimony I have heard in previous hearings, there is nothing for me to believe otherwise, and to some extent I may have uttered better than I knew. This is a very, very serious situation that severely affects small business development across this Nation. I don't know if the franchising industry understands to what extent they have moved in a sometimes collective fashion to lessen the ability of entrepreneurs to develop, to establish businesses, to be prosperous, to contribute to our society, and to make this Nation whole.

It is disturbing, Mr. Chairman, because as I indicated earlier, without your legislation that is pending before this committee, and I hope soon before this House, there does not seem to be a great deal of relief on the way. That is why I am such a proponent of it. I

need to say just one or two things to some of the individuals who have testified, and then I will yield back, Mr. Chairman.

Mr. Sánchez, it is interesting that your testimony would circle to a large extent on your relationship with McDonald's and in particular with the situation in the Pimlico/Park Heights area which sits in the heart of my district, and had it not been for my own involvement with that franchise, I guess I would have listened with a bit of awe and fascination and disbelief, but it is because of my relationship with McDonald's and with that particular location that I understand your dilemma in a different kind of way.

You see, 12 years ago in 1981 I was threatened with arrest by McDonald's because I interceded on behalf of another minority entrepreneur who had that same location, who had the exact same horror stories that you have. If there was any difference at all is that his surname was African, his ancestry was African and yours is Hispanic, but I could take your testimony and put his name on it and vice versa, it would be the same. That was 12 years ago. I led a protest boycott of that particular outlet for almost 2 weeks that year. The company came back in, took over the store. They had already taken over the store three or four times before. The husband and wife who were there had to leave. They relocated out in Ohio, I believe, and for a very long time had a great deal of difficulty trying to recover losses.

One of the gentlemen for years after that was not well off at all because of the indebtedness, and I have watched that particular outlet go to one franchisee after another, and I have watched the company come back in and take it over after, in my opinion, they have milked the individual who has gone in there for all that they have, people who have made great commitment to the store and to the area. It is one of the toughest areas in the city. It is an area with strong community organizations that are trying to make a difference, but you and I know that if the McDonald's Corp. were relocating you to Baltimore to give you a good store to operate that they would have given you a store that would not have had that kind of history, and your remarks to the extent that they refer to it as the "O.K. Corral" I find insulting to me personally as someone who goes through that community on a regular basis and insulting to you and your wife in another kind of way because they really knew better. They knew exactly what they were doing, so Mr. Chairman, it is a mixed feeling for me today because I have lived part of that particular testimony, at least Mr. Sánchez', and my distress and my anguish continue and my belief that the master/slave ontology that to some extent preexisted before the republic was founded is, in fact, manifesting itself in a different way in a different era in our Nation with respect to the relationship between franchisers and franchisees.

I want to say to Mr. Scanlon, if you could for just a moment, maybe give us an idea on your thoughts about what we can do with this particular bill and beyond it from the perspective of the NAACP Defense Fund's position of how we might be able to strengthen it and would say to Mr. Robinson, Mr. Grant, Mr. Shah, Ms. Gates that your testimony is compelling, and it calls at least for this Congress to act in a very real and forceful way. It should also call for franchisers to understand that if, in fact, they are not

part of the solution, then they are part of the problem, and while is not the entire industry, there are enough horror stories like th I think, that would give a great sense of urgency to the rest of t industry to try to find ways to clean up its act and to make su that there is some code of ethics or standards out of which they c erate and that they hold others to and that they would even e brace franchisees such as yourself and former franchisees to try find a way to improve their industry and to ensure their futu and it has got to be an approach, I think, that includes everybo in this. Otherwise they will suffer for the transgressions of many their industry who believe that the dollar is sacred, and that in vidual rights, particularly as it relates to those who come forwa as a franchisee, are really not that important.

I agree with you, Ms. Grant, you can do bad all by yourself. Y don't have to sign a contract and become a franchisee to g screwed, and it is an unfortunate set of circumstances.

I will yield with Mr. Scanlon maybe giving a couple of respons to the committee as to what the NAACP Legal Defense Fu might suggest in addition to the LaFalce legislation which I stron ly support.

Mr. SCANLON. Thank you, Mr. Mfume. I would just note at t beginning of this answer that we have seen again recently, as r cently as last Friday in another decision from the Supreme Cou the need for Congress, particularly in the area of employment d crimination, to act because after having eight decisions of the S preme Court overturned by Congress only 2 years ago, we n have another decision which strikes at the heart of employme discrimination, and this involves individual disparate treatme cases which are 98 percent of the cases not only under Title V but also under the ADA and the ADEA and every other area, s think this franchise legislation is important because it does p Congress in the position of taking a leadership role, which is qui clearly necessary given what the Supreme Court has been doing this area. I think that is something that we will also be looking work with Members of Congress on as well.

With respect to this particular legislation, the provisions I ha looked at most closely that I received from staff have involved t description of the prohibited conduct. I think one area that clearly would want to work with this committee on deals with t remedies that would be necessary, because to prohibit this condu is one thing, but I am not clear exactly on what the remedi would be for this. Given the kind of stories you have heard he today, and I am sure that they are merely representative of what out there, I think that if we have learned anything from havi civil rights laws passed by Congress, it is that unless there a strong enforcement provisions and remedies available in a mea ingful way to victims, it won't make much of a difference. Consid the fact that the civil rights laws were largely enacted in 1964. W are now in 1993 hearing the kinds of stories involving restauran and hotels and lots of other kinds of businesses which have fra chise relationships, about discrimination which is very much lil the type of discrimination that Congress heard descriptions of 1963 and 1964 when that act was originally passed.

Obviously, merely prohibiting conduct is not going to be enough to prevent it, and there has to be a real deterrent message in this legislation, and I would like to see, first of all, a strong remedy provided for people who violate the provisions and engage in the conduct that is prohibited by the statute.

Mr. MFUME. Thank you, Mr. Chairman.

Mr. SCANLON. We look forward to working with the committee and the Chairman on those issues.

Chairman LAFALCE. Thank you very much.

Mrs. Meyers.

Mrs. MEYERS. First, I would like to say thank you to Mr. Sánchez because we had some concerns about some personal references in his testimony, and most of them were excised. It is not a matter of censorship, Mr. Chairman, it is a matter of fairness, and if you are going to talk about an individual, that individual should probably be here or be given an opportunity to comment, and I do appreciate that.

Mr. SÁNCHEZ. Thank you, ma'am.

Mrs. MEYERS. I would like to ask Mr. Robinson what particular and specific changes in franchisee/franchisor law and contract law should there be to address some of these concerns that have been here this morning? Are they civil rights offenses or are they franchise offenses?

Mr. ROBINSON. Both. We have some specific recommendations in our testimony at the end that would address them. In contract law the fundamental problem is full disclosure, so that a franchisee fully understands and appreciates the relationship that they are getting themselves into with the franchisor, and the type of franchisee, meaning the nature of the operation, and the history of that operation should be fully disclosed to the franchisee.

Mrs. MEYERS. So you feel that the basic problem is in disclosure, knowing all about the site, knowing all about previous history at that site, going into it with your eyes wide open?

Mr. ROBINSON. With your eyes wide open, yes, that is one aspect of it.

Mrs. MEYERS. What is there in law now that requires disclosure? Is there nothing there now or in the agreement that requires disclosure?

Chairman LAFALCE. There is an FTC rule right now, but there is no enforcement mechanism for the individual whose rights may have been violated under the FTC rule. So you couldn't go into a court of law under the FTC rule unless the State in which you reside has passed a franchise disclosure law or what is known as a little FTC law, but we don't have very many States that have done that. There is also deficiencies within the FTC rule itself because it does not call for the type of information which is really necessary for a potential franchisee to make an intelligent judgment. What we want to do is have a body of law applicable to franchisers in all the 50 States that we think should be Federal law which creates a private right of action which could be enforced by the individual whose rights have been violated.

Mr. ROBINSON. I have nothing more to add to that.

Mrs. MEYERS. Ms. Grant, did you ask for specific information that you did not receive?

Ms. GRANT. Basically we were provided with information, I think, within the realm of what they felt the FTC under those guidelines. In looking back, I would liked to have had additional information. The problem with the agreement, the franchise agreement is you have to understand when you are buying a franchise, I know my husband and I felt that it was a proven system, so it was very difficult to say—basically to modify that agreement is almost something you can't do.

The franchisor said this is the way it is working, and it has worked for our other franchise owners, so you sort of buy into that and you say OK, we know it is a proven system, so we will buy into it, we will sign a franchise agreement as it stands, and you really feel that you cannot modify that agreement. Most business people, when you enter into a contract you feel you can modify an agreement. It is really—it is sort of an interesting thing that happens because typically when you are entering into negotiations, you do negotiate, but in franchises, it is a proven system, you don't.

Chairman LAFALCE. Some of the things that you might want to include if you could negotiate a contract is a certain standard of care from the franchisor to the franchisee. The franchisers don't want to put that in the contract, but some franchisees need a certain amount of training, other individuals need a certain amount of advertising, a support system, a lifeline system. You are dependent upon that. That one individual who sold out, somebody else bought it, so she couldn't rely upon the individual, however good or bad he or she might have been, because somebody new was taking over. She had to rely on the contract. If there is nothing in the contract which says the franchisor has any obligations, and if there is nothing within the law that says there is a certain basic standard of care that any franchisor must hold to any franchisee, then there is no check whatever on the actions of the franchisor. They can do virtually what they want. The situation should operate the same way as any automobile driver who must owe a certain basic standard of care to everybody else in the world who comes anywhere near his car. He is obligated if he is going to drive that car to operate that car with a certain standard of care, and if he doesn't exercise that standard of care, he is liable to others. If he is a cabbie, he has a more specialized obligation. He is not just a person who is operating a car casually. It is his business and he is obligated to a higher standard of care. Yet we don't have laws on the books to deal with this situation, to require a higher standard of care and fairness of those claiming to provide people with a proven system of business.

There is few relationship laws amongst the States and nothing on the Federal level with the exception of a certain limited protections for automobile dealers and for gas station owners. But that is about it. I am sorry. Go ahead. You have got more time.

Mrs. MEYERS. Mr. Scanlon, did you want to respond to that?

Mr. SCANLON. Not to that specific question. I just wanted to come back when I get a chance to Mr. Mfume's question and add something else that occurred to me.

Mrs. MEYERS. You felt that the individual that you dealt with, Ms. Gates, was—that the individual you were dealing with was not

being honest with you and direct but you—did you have nothing on paper, no contract, no agreement that was spelled out anywhere?

Ms. GATES. I would like to go back to Mr. Mfume's correlation to the master/slave relationship. During the times of slavery you had one individual in the house who represented the owner to the slaves. Mr. Pettress represented that type of individual. I think he was sincere in his caring about our community, but they put out front to us a powerless individual, so regardless if we had it in writing or not, there was never the follow-through. I also felt that American——

Mrs. MEYERS. But did you not have—when he says he would give a $5,000 lunch in exchange for a booth and your promotion of that booth, this was all on a handshake?

Ms. GATES. Handshake, and as Mr. Dickey indicated earlier, we are business people so we follow up everything in writing regardless of having the backing of a written document, the follow-through to date doesn't exist.

One of the concerns that I have about a number of the most recent franchises as compared to McDonald's, Burger Kings, et cetera, is that they have tried to attract more vulnerable groups, such as women and minorities. I have an ad from the American Speedy that was targeted to women, and it would say on average women earn about a third less than men earn, but you don't have to settle for playing the percentages. We provide comprehensive business and technical support, ongoing marketing support, and low minimum investment requirement of $30,000, so like an American Speedy, like a Hair Performers, they were supposedly more affordable.

This $30,000 for American Speedy was more like $125,000 in writing, but you got the promise that, in fact, we can lead you to funding support, we have the connections, they were working very closely with Ford Motor Credit Co. Ford Motor Credit Co. provided credit to nonminorities. In our case to date that has not been forthcoming, so there was a lot that we had in writing, but there was no one to control whether or not the follow-through and commitments were made by the American Speedy Printing Centers.

Mrs. MEYERS. Yes, Mr. Shah.

Mr. SHAH. I have specific comments regarding bill 1316 which establishes a fairness in contractual agreements. To answer your question, the problem is with the contractual agreement itself. If you read most of the franchise agreements, there is no specific performance requirement on the part of the franchisor. If he doesn't perform, you have no way to get out. If you do get out, they slap us with thousands, sometimes hundreds of thousands——

Chairman LAFALCE. There are usually hundreds of——

Mr. SHAH. Hundreds of thousands.

Chairman LAFALCE. With respect to the franchisee performance requirements.

Mr. SHAH. There is a specific performance requirement for franchisees to maintain certain standards, to maintain certain qualities. If they did not deliver on their part whether it is marketing or reservations or systems support, neither you can get out without paying hundreds of thousands of liquidated damages nor you could stay in the system, so there is no specific performance,

there is no accountability. Part of the fees that we pay are segregated funds, like a particular part of the royalty fees or other fees goes to marketing or reservations or it goes for a particular purpose.

As a franchisee, we don't have no way to verify those funds are being used for that purpose, and you dare to ask them, and you are blacklisted immediately. Part of the problem I have is the terminated or liquidated damages during the sale. If you sell your property to somebody and he doesn't want to continue the franchise, you either pay hundreds of thousands of dollars to a franchisor to get out or don't sell the business, and the prospective buyer may not have enough money to buy a franchise or does not want the franchise and want to rebrand it, he can't do it. You are just really stuck if you want to sell the property or don't sell it, and a problem I have is also with noncompete clause. A lot of people say once you get out of my franchise you just can't operate the same kind of business, and your entire life is spent doing only that business. That is all you know, how can you not afford to go in certain business?

The fundamental problem is the area of encroachment and impact. When you pay a certain amount of royalty fees you are granted certain rights to a territory. Those territories are never written anymore in the franchise agreement. They used to, depending on the business, it would be 2-mile, 5-mile, or 10-mile radius protection that nobody else would come with the same brand. It is no longer there. I mean you could have tomorrow little brand differences 2 miles, 5 miles from a successor business, and most importantly, they know you are a successful outlet. They have the revenue figures every month.

Once they know you are successful they will push other franchises to start a new outlet very close to you, and you can't do anything about it, and they don't match it with market analysis or impact and say, well, if it is 3 percent effect, it affects the revenue by 3 percent or less, there is no impact, but if it affects 3.1 or 3.2 percent. Then we won't do it.

Now, with a million-dollar gross who is genius enough to tell whether it is going to affect by $30,000 or $31,000? Most statistical studies have 3 to 5 percent margin of error, and what expert is going to tell whether you are affected by 3 or 3.1 percent, which is the borderline case. That is so ridiculous to have an impact study.

Chairman LaFalce. Nindy-nine percent of the contracts don't talk about a 3 percent impact.

Mr. Shah. That is the important thing. Those impact studies, anything that requires them to perform are not a part of the franchise agreement, so you cannot sue them. If you sue them you are always going to lose. Even if you win, you are blacklisted for your lifelong. You cannot have another opportunity with the same franchise system. You are not going to get lucrative locations. So FTC, Mr. Chairman, I would like to make sure my written testimony becomes a part of the——

Chairman LaFalce. It will be.

Mr. Shah. But FTC is the most lenient agency I have seen as far as enforcing the franchise contracts. I mean, if you read 200 pages

of legal contract that I signed after my loan was approved but the franchise won't be approved.

Chairman LaFalce. They don't enforce the contract. They are only able to enforce the disclosure requirements, not the contract.

Mr. Shah. Oh, I am sorry. I just can't believe in this day and age of mushrooming franchises, talking about one-third of the entire retail sales industry is by franchisee and we have no regulation to enforce. Even SBA or even MBD would say if you don't have franchise, I am not going to give you money. Your financing won't be approved so if you are a first-time business buyer, what do you do? Just buy a franchise that is available in a particular location. Sometimes you don't have any choice.

Mrs. Meyers. What did you want to enforce that you couldn't enforce?

Mr. Shah. The legal rights of the franchisee in a contract. What I am saying is there are certain locations in this country where you can only have one or two choices of a franchise. That means either you sign it or you don't have a business. Why? Because of the impact and encroachment problems. Suppose, to give you an example, there are five, A, B, C, D restaurants and the lender says if you do this A, B, C, D restaurants, then only I will give you money because they are a successful concept, and suppose you do an E restaurant or an E hotel or an E outlet which the lender requires to do, otherwise he will not give you financing. You literally do not have a choice but to sign whatever the franchiser of E would give you to sign because he can dictate. He knows you don't have a choice.

If you want to go into business, that is what you are going to sign because otherwise you don't have financing. So we are stuck with forcefully signing a franchise if we want to go into business or just not go into business.

Chairman LaFalce. I will come back to Mrs. Meyers shortly, but Mr. Hilliard has been very, very patient for the entirety of the hearing. I want to call on him now.

Mr. Hilliard. Thank you, Mr. Chairman. First of all, let me thank you for the series of bills you have introduced. I am somewhat familiar with the franchise system myself. About 25 years ago I did a masters thesis on the legal aspect of the franchise contract, and for those on the panel who may not understand what is being said, in a situation, in a capitalistic society we generally, wherever there is a monopoly, we generally go beyond the standard rules and regulations, and we impose as a Government certain restrictions because of the type of control exercised by the franchisee—I am sorry, by the franchisor. We should, and because of the relationship that is created when a system is purchased rather than just a contract signed, we should impose additional restrictions to make sure that the entire relationship which is always not in print is carried out under a democratic system and in a democratic system.

When a person buys a franchise, they don't just enter a contract. They buy experience, knowledge, they think they do, marketing support, and an entire support system that cannot be spelled out in the contract itself, and we need to insure that that system is completed even without that contractual agreement. It is a crime. It

ought to be a crime for a franchisor to be able to continue to resell franchises in an area where they are familiar with all the problems, have all the data and have all the control and Governments sit back and permit in a 21st Century the jobs are going to be created by the small business.

We need to make sure that that small business person has a level playing field from the beginning, and in that respect where the franchise system has not monitored and has not controlled its industry, Government ought to step in. We do it with CPA's, we do it with doctors, we do it with lawyers. If they don't monitor their system, if they don't monitor those persons in charge and in control, Government does, and at this point I understand that technically we must have this hearing to support the bill and the record, but I didn't need this hearing to know that franchisers discriminate, so I think we need to move forward with the bill. Thank you, Mr. Chairman.

Chairman LaFalce. Thank you, Mr. Hilliard. Do you have any questions?

Mr. Talent.

Mr. Talent. Thank you, Mr. Chairman. I would like to direct my questions to Mr. Sánchez. Mr. Sánchez, your statement, which I received late yesterday presents McDonald's as a company which I think you used the word, operates a system of designed and calculated indentured servitude in which it prevents large numbers of franchisees from complaining by fear and certainly you have a long personal experience with the company and you made lots of statements regarding systematically, how it operates as a system. I thought it was appropriate to put a little more perspective in the record.

In the short time I had available I have collected some information regarding the company. I thought I might go over some of that with you and try to bring that out a little bit. Do you know what percentage of the company's franchisees are minorities or women?

Mr. Sánchez. I can only give you the data that I knew back in 1991. African-American owned franchises were, I believe around 350 individuals; Hispanic franchisees were at the time about 115 to 120 in 1991.

Mr. Talent. The current data I have indicated, and if you have something to the contrary I would appreciate it if you would submit to the record, that 26 percent of the franchisees are minorities or women, that is over—out of about 2,000 franchisees, and in the current franchise training class 64 percent of the people are minorities or women, 29 percent are African-American and 19 percent are Hispanic, so certainly there are a lot of minorities who are showing some eagerness to get involved in the system which you have described as pretty horrible.

Do you know the employer who has the most successful black entrepreneurs in the system in the country? It is McDonalds. Do you know who the largest employer of black employees in the country is? You can probably guess. It is McDonald's.

You said that other minority franchisees were afraid of complaining about the company because of financial reactions. Do you know that Hispanic Magazine listed McDonalds as the 1991, 1992,

and 1993 winner of its top 100 companies for providing the most opportunities for Hispanics.

Could you explain how they would reach that conclusion based on what you feel about the company?

Mr. SÁNCHEZ. I am giving testimony of my personal experience.

Mr. TALENT. But on the basis of that testimony, you made a lot of statements about the company as a whole. I think what other minority magazines and organizations think of the company certainly bears on it. I am just trying to put a little perspective in the record.

Mr. SÁNCHEZ. I also submitted in the record minutes from a September 1991 meeting of the representatives of the McDonald's Hispanic Owners Association which listed a number of complaints.

Mr. TALENT. Are they in favor of this legislation?

Mr. SÁNCHEZ. I have not talked to——

Mr. TALENT. My information is in a letter they submitted to the committee last year. They said "Our association firmly opposes the franchise legislation." Did you know that in 1991 McDonald's was voted the corporation of the year by the U. S. Hispanic Chamber of Commerce? You have no personal knowledge of that? They were.

In 1991 and 1992, Black Enterprise Magazine voted McDonalds as one of the best places for African-Americans to work. Now, you said——

Mr. MFUME. Will the gentleman share that information with me? That is one of the best places to work?

Mr. TALENT. That is one of the reasons I asked for permission to submit a statement for the record. I thought it was important to put some of this perspective in the record since there is nobody here from the company testifying.

Mr. SÁNCHEZ. I would like to know what contributions were made to these magazines.

Mr. TALENT. It seems according to you that everybody has invidious motives about what they say about McDonalds. Everybody is either afraid to say anything or they have been bought off. You made statements based on your experience and I understand that your testimony reflects a lot of allegations in the lawsuit.

What is the status of the lawsuits now?

Mr. SÁNCHEZ. I have my attorney here, Mr. Aronofsky.

Mr. TALENT. I would be happy to direct the question to the gentleman's counsel.

Mr. ARONOFSKY. I am David Aronofsky, A-R-O-N-O-F-S-K-Y, an attorney at the Arent, Fox law firm in Washington. The case is presently on appeal in the Fourth Circuit Court of Appeals. The papers were filed this week.

The status of the case is as follows: The U.S. District Court in Baltimore dismissed Mr. Sánchez' lawsuit on summary judgment relying heavily on release and disclaimer language in the franchise agreement to conclude that even if everything alleged in the complaint by Mr. Sánchez and his attorneys is true, it is not actionable because basically the franchise agreement documents themselves have signed away right of action.

I would add that there is a pending issue about whether or not the 1991 Civil Rights Act passed by this Congress can and should

apply to certain of the Civil Rights Act claims that are in the complaint.

I would further add that I think Mr. LaFalce's legislation recognizes the legal difficulties in bringing these types of complaints under current law. That has been alluded to by other witnesses and I think the legislation that Mr. LaFalce and other members of this committee have introduced goes a long way toward making it a little bit more even for attorneys representing franchisees to bring these kinds of complaints.

Mr. TALENT. I appreciate that full explanation.

Chairman LAFALCE. Do you have more questions?

Mr. TALENT. I want to emphasize that what the gentleman just said is that the case was dismissed below on summary judgment without a trial which means that in the opinion of the judge for reasons legal or factual, the allegations didn't warrant a trial. I think it is important to bring these kinds of issues out. I did not have a lot of time to prepare.

I will submit a supplementary statement for the record containing these facts I have brought out and others.

When a company which has a reputation as far as I know of aggressively trying to recruit and advance the interests of minorities and in fact has been honored by respected magazines and organizations for doing that, I thought it was important to put a little perspective in the record. I appreciate the opportunity.

[Mr. Talent's supplementary statement may be found in the appendix.]

Chairman LAFALCE. Thank you very much, Mr. Talent.

Mr. Mfume.

Mr. MFUME. Thank you, Mr. Chairman.

I would say to my colleague and suggest for the record that if we do a clear and concise evaluation of the employment records of McDonald's—since we are talking about McDonalds today—if they are employing 26 percent of a work force who happen to be African-Americans, I would strongly suggest that 95 percent of them are in the kitchen and are being paid the lowest wages within McDonald's Corp., and that very few are in the position of being owners and they have no health insurance.

Mr. TALENT. My information is that 17 percent of the company's managers are African-American. Now I don't—I want to put some perspective on the record. It is not your intention, Mr. Chairman, to go into the hiring practices of McDonald's.

Chairman LAFALCE. I am permitting a tremendous amount of latitude to majority and minority members, but clearly this was not a hearing intended to go into the practices of any one company because I am sure there are many, many sides and there are many truths that can be seen by different sides. It was simply to document some anecdotal data regarding practices that a number of minorities have experienced so the committee could have the benefit of their personal experiences.

Mr. TALENT. I appreciate that Mr. Chairman.

Thank you.

Chairman LAFALCE. Mr. Scanlon, I think you had comments you wanted to make.

Mr. SCANLON. Thank you, Mr. Chairman.

It relates to some of the questions and answers given this morning and a response to Mr. Mfume's question about additional points the Legal Defense Fund would like to make with regard to possible clarification of the language in the bill.

One of the things that strikes me from the testimony we have heard from the witnesses and from the questions is how would you actually prove that one of these prohibited actions had occurred? That is an age-old question under civil rights laws which is particularly relevant here, because without getting into Mr. Sánchez' case, one thing that is quite clear under any statute that prohibits certain action "because of race," which this statute does, is what kind of evidence is necessary to actually prove that that has occurred.

Obviously one hope the committee has and we all have is that by passing the legislation, conduct would change to a significant extent and there wouldn't be lots of litigation, there would be less disputes because of that law.

Chairman LaFalce. We want to establish a cause of action. You are now talking about the quality and quantum of proof necessary——

Mr. Scanlon. As a simple matter in terms of the cause of action, I think it should be clarified that actions—and we have heard many examples today—taken by franchisers that have the effect or impact of discriminating against black or other minority franchisees and bear no relationship to the requirements of successfully operating a franchise should be prohibited just as they have been in the employment context since the unanimous decision in the Griggs *vs.* Duke Power case that Congress recently reaffirmed in the Civil Rights Act of 1991.

That is something very important I think just as a matter to clarify, because I think the language of the bill does prohibit such conduct, by referring to discriminating among prospective franchisees on the basis of race, sex, religion, disability, or national origin.

I think it is important to clarify either through the legislative history or possibly elsewhere that this language is intended not only to prohibit actions that are taken because franchiser actually had a discriminatory motive in taking a particular course of conduct, but also to those cases where there are practices that discriminate systematically against minority franchisees or applicants and have no reason for being taken, that is where there is no relationship between the requirements for successfully operating a franchise and this particular practice.

We have heard lots of examples, the churning example referred to. Someone could come in and say "I didn't churn for racial reasons. I wanted to make money." But If you could show that most of the victims of this churning were minority franchisees and they weren't following the same practices in the suburbs with white franchisees that should be prohibited.

If they can't give a strong reason why it is necessary for a successful operation of the franchisee or to protecting the good name of the company that is giving the franchise, I think it should be clear that that kind of unnecessary and arbitrary barrier to minority advancement should be prohibited just as arbitrary barriers in employment have been prohibited for years.

Chairman LaFalce. One of the first successful cases that I brought as a young attorney going back to the sixties was churning, a stockbroker, one of the first successful churning cases of that time.

We will work closely with you. I have sometime constraints—we have been fortunate we have not been interrupted by the bells. It is almost impossible to have a hearing these days not interrupted by the bells. I want to thank all the witnesses for coming. Those who have been in the audience, please remain for 1 minute more—this is an extremely important issue. I can't tell you how important I view it.

We have about three quarters of a trillion dollars in sales from franchised outlets today. That is big business. We are fast approaching the point where we are getting closer to one half of all retail sales coming from franchised outlets. It is mind boggling to me that we are still basically relying upon common law principles in order to enforce the rights of franchisees.

It is also mind-boggling to me that there has been such unbelievable opposition from franchiser to what I consider to be very fair, very balanced legislation. That they have been able to influence so many individuals to—it means something else, that the individual franchisees, past, present, and future, are going to have to help more in the future to stimulate activity in other committees of the Congress, to get cosponsors for my legislation, et cetera.

I mean we are going to go into more aggressive modes in the future and now is the time. I will be working with other Members much more closely in the future. Until now it has pretty much been the Small Business Committee and me working closely with Mr. Mfume, forging an alliance with him, I will forge an alliance with any Member of the Republican Party who wants to be of assistance.

I am not saying the legislation which I have introduced is perfect. One thing that strikes me today that we don't have in my bill that we probably should have is something to deal with the dual role that exists, a franchiser or franchisee, and lending borrower and the inherent difficulties in having a dual relationship of being both a franchiser and a borrower, both a franchiser and a lender that adds to the imbalance in the relationship.

I am wondering if there is anything that I could put in legislation not only to help get it passed, but to serve as a model to the States who might be considering their own action. We have been pretty successful in certain areas. The FTC did almost nothing to our hearings and they have beefed up their enforcement actions considerably since we have been pushing the hearings.

That is one significant thing. Now some franchiser associations are talking about a code of ethics. Although to my understanding they might be backtracking in a recent meeting, that franchiser complained that they went too far without adequate permission.

Why should we have a code of ethics? It will be interesting to see how that plays out.

We will be pursuing something else. I recently talked with a number of franchise people from abroad where they do have strong codes of ethics and the franchiser are very, very concerned about having the strongest possible enforcement of the code of ethics, sort

of a badge of honor for them. We don't have that sense yet within the United States. I hope we do. But I don't think self-regulation can be nearly good enough.

Now, you must have some legal recourse at all times, Federal and State. Right now there is nothing at the Federal level and nothing in the vast preponderance of the States and where you do have some recourse, it is very minimal in the remaining States.

So to the extent any and all of you can be of assistance in our endeavors, we can use that assistance and look forward to working with you.

Thank you very much.

[Whereupon, at 12:10 p.m., the committee was adjourned, subject to the call of the Chair.]

APPENDIX

Statement of

JOHN J. LaFALCE, CHAIRMAN

COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

Hearing on

MINORITY FRANCHISING: IS DISCRIMINATION A FACTOR?

June 30, 1993

This Committee has endeavored to provide the Congress with an appreciation of the growing significance of business franchising in our nation's economy, as well as an understanding of serious problems that can arise in franchise sales and franchise business relationships. Issues related to minority ownership of franchises have been a particular focus of Committee concern. Small business has long provided one of the most effective and accessible vehicles for economic advancement for minorities; and franchising is gaining increasing attention as a means to facilitate new small business growth and minority business ownership.

In a November 1991 hearing on Minorities in Franchising, the Committee received testimony documenting the disproportionately low representation of minorities among franchise owners. According to data produced by the Department of Commerce in the mid-1980s, which remains the most recent comprehensive analysis of franchise ownership, less than 2 percent of more than 478,000 franchise outlets were minority owned. While significant efforts have been undertaken since the mid-1980s to recruit minority owners in many franchise systems, franchise ownership by minorities remains, by most estimates, below 3 percent of all franchise units.

Witnesses offered the Committee a variety of explanations for this low representation of minorities among franchise owners. Several cited the limited investment opportunities available to many minorities caused by a lack of franchisor interest in minority markets, institutional bias against minority owners and lack of programs to recruit minority franchisees. Recruitment of minority franchisees was described as "superficial at best" in many franchise systems, while in others minority franchise development was considered "risky business" and "not viewed as a natural course of doing business."

Lack of access to affordable capital was also cited as a key factor not only excluding many minority applicants from acquiring franchises, but also restricting minority ownership to lower cost and less profitable franchise locations. As one witness concluded, "minorities have less capital and, therefore, less opportunities." Another witness commented, "our opportunities are usually limited to what we are presented...but this may be the only opportunity we'll get."

Even more disturbing was testimony highlighting what one witness termed "the unmistakable pattern of discriminatory and abusive practices" that many minority franchisees

encounter after purchasing a franchise business. Witnesses described several troubling practices: (1) the redlining and steering of minority franchisees to low income, depressed or minority communities while reserving more lucrative locations for white franchisees, (2) deceitful bait and switch tactics to trick minority franchisees into accepting inferior store locations, (3) discriminatory pricing and leasing policies that impose higher costs on minority owners, (4) inadequate understanding of minority markets and inappropriate training, products, advertising and support for such markets and (5) use of arbitrary or discriminatory grading systems and other tactics to limit expansion opportunities for minority owners.

The purpose of today's hearing is twofold: first, to obtain additional documentation regarding these patterns of institutional bias and discriminatory practices within franchise systems and, secondly, to address the question of whether such conduct has been a factor in limiting the availability of franchise opportunities for minority investors and in inhibiting the successful or profitable operation of franchise businesses by minority owners.

Discrimination in franchise sales and franchising practices is a serious and troubling issue. Unlike other questions in franchising, such as mandated sources of supply or pricing policies, discrimination is not a question to be debated, nor an issue on which there are "sides." It is illegal under federal law, it is immoral, and it is something we all oppose. If evidence of discrimination exists, even if limited to the cases examined today, it is a problem that must be addressed.

In addition to the testimony from the previous hearing, the Committee has received many complaints regarding discriminatory practices in a number of franchise systems. Recent news articles have also highlighted serious patterns discrimination within a number of major franchise companies. I am convinced that ample evidence exists of such practices and have therefore sought to include strong anti-discrimination provisions in the franchise disclosure and relationship proposals I have introduced in Congress.

I know these concerns are shared by many members of this Committee, and particular by Mr. Mfume, Mrs. Clayton and Mrs. Roybal-Allard, who spoke so eloquently to these concerns in our last hearing and who have co-sponsored the franchise legislation I have introduced. I wish to express my appreciation to them for their support.

Many allegations have been made that serious problems of discrimination exist in franchising. Our purpose today to assess if this is true, to understand how it is manifested in franchise sales and practices and to determine what needs to be done to eliminate it. We have with us today a diverse and extremely capable panel of witnesses to discuss these important questions. The Committee welcomes their testimony and their recommendations.

OPENING STATEMENT OF RONALD K. MACHTLEY

COMMITTEE ON SMALL BUSINESS

HEARING ON MINORITY FRANCHISING

JUNE 30, 1993

Thank you, Mr. Chairman. And I'd like to thank the witnesses for taking the time to come to our committee today to discuss franchising practices as they apply to minority-owned businesses.

As the Ranking Minority Member of the Minority Enterprise, Finance and Urban Development Subcommittee, I am extremely interested in hearing the testimony today so that we may start to develop some conclusions about whether or not some franchisees are subject to discriminatory franchising practices.

Due to difficulties that minorities already experience in the business world, it is important that this committee serve as a voice of the minority business community. Acquiring access to adequate capital in order to expand, employ workers and invest in the community is a common goal shared by minority entrepreneurs and their white counterparts. However, it has become increasingly clear that minority firms find it even more difficult to find financial backing than other business owners. As a member of this committee, it is important to me that we find out why there is a discrepancy between minorities and non-minorities and how we might be able to solve any difficulties minority entrepreneurs are having.

I am hopeful that this hearing today will provide us with some useful insight into problems minority individuals are having in the franchising industry. I am specifically interested in hearing whether the witnesses testifying today found that owning a franchise helped or hindered their ability to receive financial backing from lending institutions in order to expand the business and invest in the surrounding community. I am also interested in learning more about franchisor policy when it comes to minority ownership of a particular franchise. Are these policies consistent? If not, do we need a consistent policy?

I hope that today's hearing will help answer some of these questions and help us to further develop a policy which will give minority business owners the same opportunities as other entrepreneurs. I look forward to hearing the testimony.

JOHN J. LAFALCE, NEW YORK
CHAIRMAN

JAN MEYERS, KANSAS

Congress of the United States
House of Representatives
103d Congress
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

Opening Statement
U.S. Rep. Jan Meyers (R-KS)
Minorities and Franchising
House Committee on Small Business
June 30, 1993

Thank you, Mr. Chairman.

Like you, I am terribly disheartened and often quite outraged that too many people living in our country haven't gotten the message: All men and women are created equal and are to be treated as such regardless of race, creed, color, or national origin. I think this principle is profoundly clear and easily understood.

Unfortunately, some individuals haven't caught on to the purpose and meaning of America, and continue to discriminate against others. We have laws to defend ourselves from their actions, and when the occasion warrants, those laws should and will be exercised with full force and in a way that vigorously protects the rights of everyone involved.

But in our zeal to ferret out these wrongs, we should make sure we are placing the blame at the right doorstep. Is it franchising as a system that's at fault, or is it a few unethical individuals who are creating problems? I don't mean to trivialize the matter, but we need to discern between the bathwater and the baby. To date the committee has received anecdotal evidence of problems, but I believe we are still far from finding true widespread abuse.

We should also remember that franchising has offered countless individuals of all walks of life, persuasion, color and creed the opportunity to buy their own businesses on the main streets of rural America and on the avenues of our nation's cities. Beyond that, many of our country's franchisors actively recruit minorities and provide outstanding assistance to help them succeed and to achieve the American dream.

If we move too hastily to condemn the system, perhaps wrongly, we may cut thousands of individuals off from the very types of opportunities we're trying so hard to provide.

Now, I have no doubt that some franchisors -- and some franchisees, as well -- have discriminated against minorities and others. It's sad to say, but some non-franchising companies have, too. As have private, independent shops. As have individual citizens.

Discrimination is reprehensible wherever and however it occurs. But before we take action against it, let's be sure we are shooting at the right target and aiming accurately.

Franchising has paved the road of opportunity for thousands of minorities, and I think we would be wise to do all we can to keep that road open.

STATEMENT OF

THE HONORABLE KWEISI MFUME

BEFORE THE COMMITTEE ON SMALL BUSINESS

HEARING ON

MINORITY FRANCHISING:

IS DISCRIMINATION A FACTOR?

JUNE 30, 1993

Good morning Mr. Chairman, members of the Committee, ladies and gentlemen. I would like to thank Chairman LaFalce for holding these important hearings on franchising practices and problems. These hearings have highlighted both the advantages and the detriments of franchising as a means of owning ones own business and therefore having more control over ones own destiny. The franchising industry controls billions of dollars in revenues and offers great promise of entrepreneur opportunities.

During this series of hearings, and in private meetings, we have heard testimony from representatives of the franchise industry who argue convincingly that ethical business practices are the norm and prevail over unscrupulous convention. We have also heard, from franchisors and successful franchisees alike, that federal regulation is both unwarranted and unnecessary. There is obviously another side of this coin.

Mr. Chairman, I am particularly concerned about historical practices that may have adversely affected minority entrepreneurs, and by extension, the minority community as a whole. While most

franchise owners are reluctant to step forward to complain about abuses from an apparent fear of reprisals, those that do offer concerns often cite similar examples. Parimary among these claims are suggestions that (1) an owners ethnicity dictates where their franchise will be allowed to operate, (2) price differentials between what minorities are charged for gaining access to a franchise as opposed to their non-minority counterparts, (3) arbitrary and capricious evaluation and grading procedures designed to limit potential expansion, and the list continues.

While all of these claims cause great concern for me, I am perhaps most concerned about the inability of franchisees to redress grievances against their principal due to the imbalance in the relative bargaining positions of parties to the contract, and the seemingly standard practice of negotiated deals that fall outside the four corners of the express or written contract. Given that prosperity or ruin can be determined by these informal arrangements that are not evidenced in writing, when the franchise deal does not meet the expectations of either party, franchisees are left at the mercy of the franchisor.

Given the sheer volume of current legal decisions finding discrimination in banking, housing, education and employment, absent some compelling evidence to the contrary, it would be disingenuous to suggest that race and ethnicity play no role whatsoever in business decisions affecting opportunities for

minorities in the franchise industry.

Mr. Chairman, I thank you once again for conducting this hearing today to allow the committee to consider testimony from this distinguished group of witnesses on a topic that is of primary importance me, and the minority business community in general. I look forward to their testimony.

STATEMENT BY CONGRESSMAN JIM RAMSTAD OF MINNESOTA
BEFORE THE HOUSE COMMITTEE ON SMALL BUSINESS
June 30, 1993

HEARING ON MINORITY FRANCHISING

Mr. Chairman, franchises are extremely important to the American economy -- and can be an important way for the minority community to gain access to business ownership.

As I've noted at past hearings on the topic of franchises in general, nearly one-third of all goods and services in this country are sold through franchises.

John Naisbitt, the author of Megatrends, estimates that this figure will rise to around 50 percent by the year 2000.

Franchises employ over 7 million people in this country -- and have been a consistent source of new jobs in our beleaguered economy.

That's why it's important to have fairness in franchising while avoiding over-regulating these important small business entities.

Thanks again, Mr. Chairman, and I look forward to hearing from our witnesses today.

SUPPLEMENTAL TESTIMONY OF REP. TALENT

I appreciate the inquiry of the Chairman and his Committee into the franchise laws of the United States. However the Small Business Committee is an inappropriate forum for airing isolated, personal grievances, which in the instance of Mr. Joseph Sanchez, who testified before the Committee on June 30, have been fully reviewed and dismissed by a Federal Court.

Mr. Sanchez, an ex-franchisee of McDonald's Corporation aired his complaints and allegations against McDonald's for 27 minutes before the Committee. It is my understanding that these were the very complaints and allegations on which the District Court for Maryland rule granted summary judgement in favor of McDonald's Corporation. The individual facts of the case dismissed by the Federal Court speak for themselves. All of the facts were made known to the Federal Judge. The complaint to the court was subject to almost two years of depositions taken from more than two days of legal arguments before the Federal Judge on the summary judgement motion. While I understand that this individual case is under appeal, a balanced, full disclosure of information about McDonald's relationship to minority franchisees is called for and will appropriately provide balance to Mr. Sanchez's testimony.

I have gotten to know McDonald's regional office people in St. Louis and have met with several franchisees and company employees.

To the end of shedding more light on McDonald's relationship with minority franchisees and minority employees and suppliers, I would like to share a few additional facts on how the company conducts itself and how others judge it in the marketplace. Therefore, I submit the following:

McDonald's believes that by embracing the benefits a diverse work force can offer, it will create greater resources and opportunities to manage the ever-changing marketplace. I believe their commitment to diversity extends beyond employees. McDonald's has over 9,000 U.S. restaurants, and 85% of these are operated by independent owner/operator franchisees. Over the past several years, McDonald's has increased the percentage of franchised restaurants from a level of about 75%, where it was for many years, demonstrating their commitment to franchising as a way of doing business.

McDonald's has 2,614 individual franchisees in the U.S., and 26% of those franchisees are women and minorities. That group owns 18% of the company's franchised restaurants. Since 1986, the number of minority and women franchisees increased by more than 100%, and the number of restaurants they own by nearly 120%. In 1992, the average sales of a McDonald's restaurant open for over one year was $1.7 million.

Of the current franchisee applicants in training, 63% are minorities and women, and 29% of those are African-Americans and

19% are Hispanic. The number of new Hispanic franchisees increased by almost 13% from 1991 March 1993, and the number of Hispanic-owned restaurants increased by 11% in the same period.

Today, minorities and women represent more than half of McDonald's customers and employees. McDonald's employs a veritable United Nations of ethnicity. Minority and women employees in McDonald's executive ranks represent 53% of total middle managers, 49% of department heads, and 25% of executives. Since 1979, McDonald's has provided career development and management seminars tailored to the special needs of its diverse employee base. The company reports that more than 14,000 employees have participated in more than 900 seminars on such topics as Managing the Changing Workforce, Women's Career Development, Black Career Development, Hispanic Career Development, and Managing Cultural Differences.

Every year, about 3,000 employees complete affirmative action training through Mid-Management Training Classes and Advanced Operations Courses offered at its training Center, Hamburger University. To further support the growth and development of its employees and franchisees, and to enable them to share common perspectives and experiences, McDonald's has organized networks for minority and women employees and franchisees that meet regularly, and whose representatives confer on an ongoing basis with McDonald's management. In addition to a management "open door" policy for employees and franchisees to discuss concerns, the company has for many years conducted an ombudsman program that

includes peer review, and has recently joined with other leading franchisors in adopting an independent dispute mediation program for franchisee issues that cannot be resolved within the McDonald's System.

McDonald's has a strong record in minority purchasing. 1992 purchases from businesses owned by minorities and women were $400 million, of which $167 million were purchases from Hispanic suppliers. McDonald's has a minority banking program that dates to the 1970's. McDonald's Corporation has lines of credit as well as depository and service- based relationships with many minority-owned banks, some of which also provide financing to its franchisees.

McDonald's devotes substantial resources to marketing programs specifically designed to reach minorities. In 1991, McDonald's expenditures for minority media, agency support, talent and residuals were reported to be $34 million. McDonald's Black and Hispanic national advertising agency is Castor Advertising Corporation, the largest 100% Hispanic-owned agency specializing in segmenting marketing communications.

These efforts highlight a longer term commitment and diversity. McDonald's hired its first 100 percent Hispanic- owned advertising agency in 1976, and Castor has represented McDonald's for the past four years. Burrell has represented McDonald's since 1972. Moreover, in January, 1993, McDonald's retained Valencia, Maldonado

& Echeveste (VME) as its first national Hispanic public relations agency. VME, an independent Hispanic-owned and operated agency located in Pasadena, CA, was selected after a nationwide search of Hispanic agencies.

McDonald's is the largest single brand advertiser on Spanish-language television, and employs more Hispanic talent than any other single brand advertiser. McDonald's is the largest advertiser in Black and Hispanic media in the quick- service restaurant industry.

McDonald's franchisees and executives serve on the boards of many national and local organizations dedicated to helping minority communities, including SER-Jobs For Progress, the National Council of LaRaza, the National Urban League, the United States Hispanic Chamber of Commerce and the Women's Food Service Forum.

Since its founding in 1984, Ronald McDonald's Children's Charities (RMCC) has given more than $44.5 million to not-for-profit organizations that help children and their families, and have benefitted many minority groups. In 1975, the first Ronald McDonald House was established as a "home away from home" for more than 1.6 million members of families of seriously ill children treated by nearby hospitals. Some 30 percent of the families served in 1991 by the 120 Houses in the U.S. were minorities.

RMCC and McDonald's local markets have contributed more than $2

million to Hispanic educational programs, including $600,000 in local HACER (Hispanic American Commitment to Education Resources) scholarships to help Hispanic students obtain a college education. Since 1977, the McDonald's system has contributed more than $8 million to the Negro College Fund. McDonald's All-American High School Basketball Game, which features the nation's greatest players, donates its proceeds to children's charities. McDonald's Black History Makers of Tomorrow honors outstanding high school juniors who have demonstrated the potential to influence Black history.

Some other national programs that benefit local minority communities are: The Hispanic Family of the Year program, sponsored jointly with Ford; McDonald's Gospel Fests; and, McDonald's Summer of Family Reading educations outreach program, developed with the National Council of LaRaza.

McDonald's has been extensively recognized by national and local business, civic and community organizations for its efforts to provide opportunities for minority franchisees, suppliers and employers. Some of this recognition includes:

-- 1993, 92 and 91 - One of Hispanic Magazine's 1200 companies Providing the Most Opportunities for Hispanics and one of Black Enterprise Magazine's Best Places for Blacks to Work.

-- 1991 - Corporation of the Year Award from the United Hispanic Chamber of Commerce, which also named McDonald's franchisee Virginia Ojeda Hispanic Business Woman of the Year.

-- 1990 - Top 100 Employers Award from the Black Collegian magazine and Employer of the Year Award from the Hipanic Alliance for Career Enchantment.

In 1985, McDonald's acknowledged its ongoing commitment to minority business development by signing the NAACP Statement of Fair Share Principals. The company reaffirmed this commitment on 1988 by being among the first corporations to sign the Hispanic Alliance for Corporate Responsibility's Statement of Economic Principles.

I believe the information above reflects positively on the enormous commitment McDonald's has to the success of minorities and women throughout their System, and raises great doubt about the isolated and questionable allegations raised before the Committee by a single ex-franchisee, whose complaints had been summarily dismissed by a Federal Court just weeks before the June 30 hearing.

On a final note, let me say how great I feel is the need to change the way we address the issue of race relations. Twenty eight years have passed since the enactment of the Civil Rights Act of 1964 and Voting Right Act of 1965, two fundamental strides towards individual justice. A whole network of laws has been erected to

eliminate discrimination and promote affirmative action, and certainly the country has needed a very high level of awareness of these issues. Yet the people of our country are growing farther apart. Few people from any of the racial or ethnic communities feel that we are making progress. The people I talk to think that the country is growing more bitter, not less, more racially divided, not less.

I believe there are several reasons for this. First, there are fundamental differences of opinion about the basic direction in which our policies should go. Because of the extreme sensitivity of these issues, and the atmosphere of distrust in the community, it is difficult for reasonable people to discuss these issues honestly. This means that on specific questions, people are often talking past each other, which greatly raises the level of frustration.

Second, because these issues matter so deeply, and arise from enormous historical injustices, it is very easy for political leaders to manipulate these issues. There are quite simply too many demagogues on all sides. They promote the atmosphere of distrust which makes communication so difficult.

It is very clear that both sides have to be careful to move strongly against racism where it does exist and to be careful about alleging racism where it does not exist. People and companies who do have a record of credibility should be encouraged rather than attacked.

TESTIMONY OF ANTHONY W. ROBINSON, PRESIDENT
MINORITY BUSINESS ENTERPRISE LEGAL DEFENSE AND EDUCATION FUND, INC.
BEFORE THE U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS
HEARING ON "MINORITY FRANCHISING: IS DISCRIMINATION A FACTOR?"
2359 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, D.C.
WEDNESDAY, JUNE 30, 1993

Good morning. My name is Anthony W. Robinson. I am President of the Minority Business Enterprise Legal Defense and Education Fund, Inc. ("MBELDEF)

The Fund is a national non-profit public interest law firm that was founded in 1980 by the former Chairman of this Committee, the Hon. Parren J. Mitchell. The principal mission of MBELDEF is to defend and protect the class interests of the minority business community through litigation. Initially, MBELDEF's litigation efforts were focused exclusively upon defending the constitutionality of minority business programs. However, in more recent years, the Fund's litigation agenda has broadened considerably to include lawsuits to enforce the implementation of minority business programs, and also to attack discrimination in the marketplace. It is in this latter context that MBELDEF has gained considerable experience with the plight of minority franchisees, and from this experience that I come to offer testimony today.

MBELDEF's first encounter with discrimination against minority franchisees came in 1988 when we were approached by several minorities in the Burger King Corporation franchise system that expressed deep frustration and anger about the systematic and pervasive patterns of discrimination that undermined their survival. At first, there were a dozen minority franchisees, and then twenty-four Black, Hispanic, and Asian-Indian franchisees in the Burger King system that came forward to address Burger King's

discriminatory and anticompetitive conduct towards them through a massive class action lawsuit. Those twenty-four plaintiffs represented a prospective class of hundreds of past and present minority-owned franchises within the Burger King system.

When MBELDEF filed that massive class action lawsuit in October of 1988, extensive coverage by the major print and electronic media resulted in heightened awareness of the devastating impact of discrimination on minority franchisees. Almost overnight, MBELDEF's office was deluged with calls from all over the nation from former and present minority franchise owners who had suffered through similar experiences. At first, there were calls from franchisees in major fast food restaurant chains. Then there were calls from minority-owned car dealerships. Finally, a group of Black Seven-Eleven franchise owners from the Maryland-D.C.-Virginia area approached MBELDEF to evaluate litigation options to address discriminatory and oppressive franchising practices in the Seven-Eleven system. Ultimately, those minority franchisees decided not to pursue litigation due to financial constraints and vulnerability to retaliation.

The commonality of complaints from the minority franchisee community was astounding. Regardless of the region or type of franchise (fast food restaurants, car dealerships, or convenience stores), the unmistakable pattern of discriminatory and abusive practices was evident. Almost to a person, each minority franchisee complained that their franchisor engaged in a variety of discriminatory conduct, including:

(1) redlining and steering most minority franchisees to low-income, depressed urban locations, while reserving more lucrative locations for white franchisees;

(2) price discrimination in charging minority franchisees more for the leasing and purchase of stores and equipment;

(3) use of a discriminatory and arbitrary grading system as

a means of limiting and preventing the expansion of minority franchisees to more lucrative suburban markets or commercial districts;

(4) deceitful "bait and switch" tactics to trick minority franchisees into accepting inferior facilities and store locations; and

(5) vicious retaliation against those minority franchisees that dare to complain about discriminatory treatment.

As a result of these practices, many minority franchisees find themselves in a financially vulnerable situation. Their cash flow is negative. Due to depressed sales and substantially higher costs than their white counterparts, they frequently are unable to meet all of their financial obligations under their franchise agreements. As a result, minority franchisees can often find themselves at the mercy of the franchisors that set them up for failure in the first place. Under the terms of most franchise agreements, the franchisor has the option of terminating the franchise agreement and seizing property and equipment if the franchisee misses even a single payment. When minority franchisees have filed suit against discriminatory treatment, retaliation has been swift and harsh. Several have been forced into bankruptcy.

Our judicial system has proven woefully inadequate to protect minority franchisees from such retaliation. Motions for preliminary injunctions to prevent termination of franchises were not even responded to by the court in three years of litigation in the Burger King lawsuit. Moreover, after three years of litigation, and hundreds of thousands of dollars in legal fees, the Burger King case never went to trial. Several of the Burger King plaintiffs have gone out of business in the interim. Perhaps the far-reaching implications of an overburdened and non-responsive judicial system should be the subject for another hearing before another Committee of Congress. However, this sad reality makes it imperative for this Committee and this Congress to act immediately

to provide greater protections to minority franchisees.

MBELDEF urges this Committee to consider several remedial approaches. New legislation for fairness in franchising is sorely needed. The features of such legislation should include requirements for franchisors to make full disclosures to prospective franchisees regarding sales history and sales projections for franchise locations. There should also be a prohibition against unfair trade practices in franchising, such as price discrimination, "bait and switch" tactics, and the intentional refranchising of hopelessly unprofitable sites. Moreover, the Federal Trade Commission should be directed to engage in rulemaking or conduct investigations to enforce this legislation. Due to the grossly inferior bargaining position of franchisees, it might also be useful to create an independent franchise arbitration board to resolve franchisee complaints of this nature. An anti-discrimination statute to outlaw redlining of minority franchisees and impose criminal penalties would also be beneficial. Finally, MBELDEF urges this Committee to hold annual oversight hearings to monitor the financial health of minority franchisees, and the enforcement actions of the FTC in this area. Major franchise chains should also be called upon to present detailed plans and progress reports concerning their efforts to improve, not only the numbers of minority franchisees in their systems, but also the financial standing of those minority franchisees.

While I recognize that this is a tall order to undertake, I sincerely hope that my testimony here today has at least been somewhat helpful in leading you towards a vitally important first step in achieving fairness in franchising. Thank you.

RACIAL AND ETHNIC DISCRIMINATION IN RESTAURANT FRANCHISING

Kerry Alan Scanlon, Esq.

NAACP Legal Defense and Education Fund, Inc.
1275 K Street, NW
Washington, DC 20005
(202) 682-1300

Marc Bendick, Jr., Ph.D.

Bendick and Egan Economic Consultants, Inc.
3760 39th Street, N.W.
Washington, DC 20016
(202) 686-0245

A Statement before the
Committee on Small Business
U.S. House of Representatives

Hearings on
Minority Franchising:
Is Discrimination a Factor?

June 30, 1993

Mr. Chairman and Members of the Committee:

We appreciate this opportunity to participate in these hearings on discrimination against minorities in franchising. I am Kerry Alan Scanlon, Assistant Counsel in the Washington Office of the NAACP Legal Defense and Education Fund. Joining me in this testimony is Dr. Marc Bendick, Jr., an economist who has conducted research on discrimination.

The franchise restaurant industry is a very large economic enterprise, with the fifty largest franchise companies alone generating $76.2 billion in revenues annually. That sales volume is achieved through some 64,000 franchised restaurant units as well as 20,000 company-owned restaurants. The largest firms in the industry are all familiar names; listed in descending order of system-wide revenues, the twenty largest are: McDonald's, KFC, Burger King, Hardee's/Roy Rogers, Wendy's, Taco Bell, Domino's Pizza, Dairy Queen, Little Caesar's, Subway, Denny's, Arby's, Shoney's, Dunkin' Donuts, Jack in the Box, Big Boy, Sizzler, Long John Silver's, Baskin-Robins, and Ponderosa.[1]

Testimony received by this Committee at an earlier hearing has made clear that minorities are significantly under-represented in franchising. The title of this hearing moves beyond this finding to pose a specific question, namely: "In explaining the under-representation of minorities in franchising, is discrimination a factor?"

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[1]"RB's Annual Franchising Report: The Top 50," Restaurant Business, June 10, 1993, pages 74 and 78. Figures are for 1992 and include both domestic and international sales.

In the franchise restaurant industry, available evidence suggests that discrimination is not only a factor but a major factor. Discrimination appears to hamper minority participation in franchising both directly--that is, in the ways franchisor companies select and treat franchisees and potential franchisees--and indirectly--that is, through discrimination in the capital and employment markets that qualify persons as potential franchisees.

Our testimony this morning provides evidence in support of these conclusions. Of equal importance, it suggests the need for expanded disclosure to support more comprehensive and specific answers to the Committee's question.

Employment Discrimination
in the Restaurant Industry

The most direct form of discrimination arises when, as equally qualified minority and non-minority candidates seek to become franchisees, minority candidates are systematically less successful than non-minorities--either refused franchise opportunities or offered inferior opportunities.

One indirect indicator that this occurs in the franchise restaurant industry comes from employment practices. Discrimination against racial and ethnic minorities in hiring, assignment, treatment, promotion, and retention appears widespread in the restaurant industry, particularly with respect to managerial positions.

Consider, for example, the facts alleged in a recently-settled civil suit against Shoney's, Inc., in which the NAACP Legal Defense

and Education Fund was one of the counsel for plaintiffs. In that litigation, it was alleged that the company engaged in discriminatory behavior in employment that included:[2] confining blacks to kitchen positions and precluding them from customer contact positions such as servers; precluding blacks from managerial opportunities both at the restaurant level and at corporate central offices; repeated use of racial slurs and epithets; and retaliation against whites who refused to comply with company policies discriminating against blacks. Shoney's, Inc. is the thirteenth largest franchise restaurant company in the nation, operating more than 750 company-owned restaurants and 700 franchised restaurants in 35 states. Discriminatory practices were attributed to several hundred named company supervisors, managers, or officials--including the company's former chairman and chief executive officer--and the settlement reached in the case provides $105 million in back pay to be distributed among some 25,000 claims from aggrieved minority employees or job applicants.

One way that such employment discrimination limits opportunities for minorities in restaurant franchising is by precluding them from acquiring restaurant management experience. Many franchise chains prefer franchisees who have prior managerial experience within the company's own system, or at least elsewhere

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[2]Memorandum in Support of Plaintiffs' Motion for Summary Judgment on the Issue of Liability, in Haynes et al. v. Shoney's, Inc., et al. (PCA 89-30093-RV, United States District Court for the Northern District of Florida, Pensacola Division), July 24, 1989.

in the restaurant industry.[3] In restaurant chains in which the vast majority of managers are white, this practice has an strong adverse effect on franchising opportunities for minorities.[4] For example, in the Shoney's restaurant system, the company for many years did little outside recruiting of potential franchisees and relied heavily on former company executives such as area supervisors or division directors to undertake the franchisee role; prior to settlement of the litigation just described, these managerial ranks were alleged to have been almost totally closed to blacks.

Even when minorities have accumulated appropriate restaurant experience, qualified minority individuals often are still not hired or promoted in proportion to their qualifications. In recent years, careful statistical studies have been conducted by nonprofit research organizations seeking to measure the extent of discrimination in the American labor market today. These studies have involved several thousand "tests"--essentially, controlled experiments in which matched pairs of research assistants--one minority and the other non-minority--are trained as skilled job applicants, equipped with resumes describing equal qualifications

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[3]This practice is particularly common for chains in which restaurants operations are relatively complex--that is, in table-service restaurants with extensive menus--rather than counter-service fast food stores.

[4]One minority individual who has moved from internal manager to restaurant franchising is Mr. Larry Lundy, a black Pizza Hut Vice President of Restaurant Development who subsequently became a franchisee with 31 Pizza Huts units in the New Orleans area. See "Few Franchises are Owned by Minorities," USA Today, June 11, 1993, page B-1.

for employment, and then assigned to apply for real job vacancies such as those advertised in the "help wanted" sections of major newspapers. The results are carefully recorded and analyzed, resulting in estimates that the net rate of race/ethnic discrimination in hiring in the restaurant industry is approximately 25 percent. That is, one in four times when two equally qualified applicants--one white and one minority--sought restaurant employment, the minority was treated substantially less well than the non-minority--refused an opportunity to interview that was granted to her/his matched partner, denied a job offer that was made to her/his partner, or offered an inferior job.[5]

These testing studies were conducted primarily for relatively low level restaurant positions such as servers, hosts, and assistant managers. For more senior managerial jobs comparable to that of restaurant franchisee--such as restaurant managers or regional supervisors--a substantially higher rate of discrimination undoubtedly prevails. Nationwide, blacks and Hispanics account for 33.1 percent of low level food preparation workers (such as dishwashers) and 31.2 percent of waiters' and waitresses' assistants ("busboys"). Yet in an industry in which experience is often more important than education and internal upward mobility is

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[5]See Marc Bendick, Jr., Charles W. Jackson, and Victor A. Reinoso, Measuring Discrimination Through Controlled Experiments (Washington, D.C.: Fair Employment Council of Greater Washington, Inc., 1993); Marc Bendick, Jr., Charles W. Jackson, Victor A. Reinoso, and Laura E. Hodges, "Discrimination Against Latino Job Applicants: A Controlled Experiment," Human Resource Management 30 (Winter 1991), pp. 469-484; and Michael Fix and Raymond Struyk (eds.), Testing for Discrimination in America (Washington, D.C.: Urban Institute Press, forthcoming 1993).

relatively high, blacks and Hispanics account for only 14.3 percent of food service managers.[6]

Discrimination in Obtaining Finance

One primary motive for restaurant companies in granting franchises is to finance expansion of the chain without diluting ownership in the parent company or increasing its debt. Potential franchisees typically must provide "front end" investment funds sufficient to cover a substantial initial franchise fee, acquisition of real estate and equipment, and working capital to sustain the operation during its initial startup period. For franchisees of the fifty largest franchise restaurants companies, initial investment requirements for a single restaurant is reported to range from perhaps $100,000 to well over $1 million.[7]

Restaurant franchisors typically require that franchisees provide between 20 percent and 40 percent of their investment in the form of equity, while the remainder can be borrowed.[8] So, for example, to acquire a restaurant franchise with an initial

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[6]These figures are calculated from the 1990 Census reported in Detailed Occupation and Other Characteristics from the EEO File for the United States (Washington, D.C.: U.S. Bureau of the Census, 1990-CP-S-1-1, October 1992), Table 1. Minority representation among private sector restaurant managers is undoubtedly less than the 14.3 percent figure cited in the text because that figure also encompasses positions (such as managers of hospital kitchens and school cafeterias) where minority representation is higher than in for-profit restaurant companies.

[7]"RB's Annual Franchising Report: The Top 50," Restaurant Business, June 10, 1993, page 73.

[8]Mahmood A. Kahn, Restaurant Franchising (New York: Van Nostrand, 1992), pages 90-92.

investment of $500,000, a franchisee might provide $100,000 from personal assets such as a savings account or by taking a second mortgage on her/his residence, and borrow the other $400,000 from a commercial bank or a private investor. If discrimination against minorities limits their access to mortgage finance, personal loans, commercial loans from banks or private placement, or venture capital, then their participation as restaurant franchisee will be severely hampered.

Unfortunately, such discrimination in American capital markets is pervasive and well-entrenched. As has been extensively documented through careful research, this discrimination operates both against individuals who are members of racial or ethnic minority groups and against residences or firms located in neighborhood that are dominated by racial and ethnic minorities (redlining).[9]

While the previous paragraph refers to discriminatory decisions made by financial institutions--banks and investors--restaurant franchise companies can also reasonably be considered at least passive participants in those discriminatory acts. As noted at the beginning of this testimony, the major franchise restaurant companies are huge enterprises, controlling billions of dollars in

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[9]See, for example, "Discrimination in the Housing and Mortgage Markets," Housing Policy Debates 3 (1992); Timothy Bates, Banking on Black Enterprise (Washington, D.C.: Joint Center for Political and Economic Studies, 1993); The Community Reinvestment Sourcebook (Washington, D.C.: National Community Reinvestment Coalition, 1993); Julia Parzen and Michael Kieschnick, Credit Where It's Due: Developing Banking for Communities (Philadelphia: Temple University Press, 1992); and Gregory Squires (ed.), From Redlining to Reinvestment (Philadelphia: Temple University Press, 1992).

revenues and assets. When they choose to do so, these companies can readily bolster the financial access of individual applicants through such means as waivers of certain financing requirements, co-financing from company-internal resources, or provision of loan guarantees to outside lenders. At the same time, these large companies are major customers of the banking industry and other financial institutions. Both as individual companies and acting jointly through their industry associations, the franchise restaurant industry is well positioned to pressure financial institutions to conduct their activities in a non-discriminatory manner.

The Potential for Discrimination in the Quality of Franchise Offers

Minority access to franchising opportunities in the restaurant industry cannot appropriately be measured solely in terms of the number or proportion of franchisees owned by minorities. In particular, attention must be paid to the specific terms and conditions of the deals granted to individual franchisees. While franchise chains typically utilize a standard format for contracts between them and their franchisees,[10] many details of each deal are subject to individual negotiation. For a franchised restaurant, the difference between profitability and non-profitability may be determined by such operational matters as the number of employees who will be trained by the franchisor, the schedule on which the

[10]See, for example, the sample contracts in Mahmood A. Kahn, Restaurant Franchising (New York: Van Nostrand, 1992), Appendix.

franchise operation will be brought on stream, the budget allocated by the franchisor for promotions and advertising in the unit's local market, and whether the area supervisor assigned to the franchise unit is skilled and energetic. Discrimination in some of these details might be investigated by comparing the terms of written contracts awarded to minority and non-minority franchisees. However, many of these arrangements are matters of informal agreement and operational decisions that are not recorded or readily observed. In these circumstances, one important signal that a franchisor firm may be discriminating against minority franchisees would arise if minority-owned franchises within a chain fail or turn over at consistently higher rates than comparable non-minority franchises.[11]

Of all the negotiable aspects of an individual restaurant franchise deal, by far the most important is the location of the restaurant. Many minority-dominated neighborhoods are characterized by limited consumer purchasing power. At the same

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[11]An extreme case of such problems arises with restaurant franchise firms that engage in "churning"--that is, sale of franchises that rapidly and repeatedly fail. In some cases, such activities may particularly target minorities, taking advantage of the fact that their access to more attractive franchise opportunities is limited by discrimination.

The practice of "churning" appears to be more commonly associated with small, shorter-lived franchise chains rather than with large, long-established companies such as those on the list in footnote 1. One warning signal that a chain may be oriented toward such practices is franchise contracts under which the franchisor's financial stake in the ongoing success of the franchisee is limited (for example, when the franchisor's revenues are derived primarily from initial franchise fees rather than a proportion of franchisees' ongoing revenues or profits). Another signal is that the chain has few company-owned restaurants sharing the same customer reputation as franchisee-owned restaurants.

time, location in these neighborhoods is sometimes associated with high operating costs to cover such items as security and staff training.

Reflecting these considerations, in some cases locations in neighborhoods with predominantly minority residents offer more limited profit opportunities for franchisees than locations in more affluent neighborhoods, for example in the suburbs or downtown. In other cases, however, the opposite is true, with locations in inner-city or minority-dominated neighborhoods offering excellent profit opportunities reflecting limited competition, lower operating costs (for example, arising from low rents), and a good match between the restaurant format and the consumer preferences of neighborhood residents.[12] Which of these circumstances prevails in an individual case depends on the specific circumstances in the neighborhood and the market niche of the restaurant.

In light of these facts, it is not necessarily appropriate to conclude that when minority franchisees operate restaurants located in minority-dominated neighborhoods they were forced to do so by discrimination on the part of the franchisor. That conclusion may well be justified, however, if within a particular restaurant chain, inner-city or minority-dominated locations are consistently less profitable than their counterparts in more affluent suburban areas and minority franchisees are found exclusively or nearly-

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[12]See Marc Bendick, Jr., and Mary Lou Egan, "Linking Business Development and Community Development in Inner Cities," Journal of Planning Literature 8 (August 1993), pages 3-19, and Timothy Bates, Banking on Black Enterprise (Washington, D.C.: Joint Center for Political and Economic Studies, 1993), especially chapter 4.

exclusively in these locations. An alternative way to examine the same issue is to consider whether minority franchisees voluntarily selected inner-city locations from among a range of inner-city and suburban alternatives or whether the franchisor company considered them only for minority-dominated locations.

One example of a potentially-suspect arrangement has been reported in the Denny's chain where, among one set of 168 franchisees, the only franchisee who is black operates a franchise in the Watts ghetto of Los Angeles.[13] A second example (this time reflecting assignment of managers in company-owned stores rather than franchisees) is provided by practices within Shoney's, Inc., prior to settlement of the suit discussed earlier in this testimony. Within Shoney's, the limited number of black restaurant managers employed by the company were found almost exclusively in Lee's Famous Recipe Fried Chicken restaurants or Captain D's fish restaurants located in black neighborhoods--operations with a large black customer base--rather than in restaurants operated under Shoney's own name located in suburbs or on major highways.[14] Although systematic data on this subject are seldom available, anecdotal evidence suggests that such patterns are typical of personnel assignments in a number of other restaurant franchise chains as well.

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[13]"Few Franchises are Owned by Minorities," USA Today June 11, 1993, page B-1.

[14]Declaration of Marc Bendick, Jr., in Haynes et al. v. Shoney's, Inc., et al., (PCA 89-30093-RV, United States District Court for the Northern District of Florida, Pensacola Division), November 11, 1991, pages 14-16.

Concluding Observations

Based on the empirical information we have presented, we offer three concluding observations.

Our first observation is that this Committee should generally view with skepticism an explanation that is often offered by representatives of the restaurant industry or restaurant companies when confronted with evidence of discrimination against minorities. That explanation is that, if the allegations are true, they reflect only the unauthorized behavior of a limited number of atypical, "rogue" individuals. The evidence we have cited suggests that discrimination (1) may well spread widely across a number of different large franchise restaurant companies, (2) is sometimes observed pervasively across local operating units within these companies, and (3) may often arise consistently across multiple aspects of company operations. In such situations, these patterns may reasonably be interpreted as reflecting the central policies, management attitudes, and corporate cultures of the franchise restaurant companies--policies, attitudes, and cultures that may simultaneously undergird discrimination against minority restaurant franchisees, discrimination against minority restaurant employees, and discrimination against minority restaurant customers.[15]

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[15]Discriminatory treatment of minority customers by restaurant chains has recently received extensive public attention through media coverage of several suits brought against Denny's by black customers. For example, six uniformed Secret Service agents assigned to protect the President of the United States allege that they were provided service at a Denny's in Annapolis, Maryland that was slower than that accorded white customers; the wife of a black

Our second observation is that restaurant franchise companies that seek to improve opportunities for minorities can often achieve progress rapidly. Shoney's, Inc. provides an illustrative example. Since 1989, the company has increased the number of restaurants owned by black franchisees more than five-fold and moved to 43rd rank on the "top 50" franchisor list published Black Enterprise magazine.[16] This progress is still relative, however, in that the company has developed franchise relationships with only half a dozen black individuals, and the slightly more than 30 restaurants these franchisees operate account for only about one-half of one percent of all Shoney's restaurant units. Nevertheless, these are steps in the right direction.

Our third and final observation concerns the availability of

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federal judge alleges that the couple was discriminatorily provided slow and discourteous service at a Denny's in Northern California; numerous black customers allege that they were required to prepay for meals when white customers were not; a California family alleges that Denny's offer of a free birthday meal was not fulfilled for their daughter because of her race; and black customers from Florida to California allege that they were refused service. See Plaintiffs' Memorandum of Points and Authorities in Opposition to Defendants' Motion to Dismiss in Ridgeway et al. v. Denny's Inc., et al. (C-93-20202 JW, United Sates District Court for the Northern District of California), June 15, 1993.

Consistent with such allegations, interviews conducted by a sociologist with 210 middle class and upper class black persons in 16 cities indicated that ninety percent of them had experienced significant instances of discrimination in restaurant service, including refusal of service, slow and inferior service, and being seated near the kitchen or hidden at the back of restaurants. See "Black Travelers Talk about Bias," Conde Nast Traveler (November 1992), page 44, and Joe R. Feagin, "The Continuing Significance of Race: Antiblack Discrimination in Public Places," American Sociological Review 56 (February 1991), pp. 101-116.

[16]"B.E. Franchise Overview: Franchising Grows Up," Black Enterprise, September 1991, pages 53-66.

information. To further examine the matters discussed in this testimony, it would be very useful to have industry-wide data that profile company practices and outcomes across the franchise restaurant industry. With respect to internal employment practices, large companies are required to provide periodic reports to the Equal Employment Opportunity Commission on the race/ethnic and gender composition of their work force. The Community Reinvestment Act requires banks to inform federal regulators concerning the extent to which they lend money in the neighborhoods in which they receive deposits. Securities regulations mandate disclosure to potential investors of financial and managerial information concerning enterprises in which they might invest. Comparable disclosure with respect to minority participation in franchising should include (although not be limited to) information on: how many minorities hold franchises, the rates at which minorities and non-minorities are selected from pools of qualified applicants, where the franchises held by minorities and non-minorities are located, and the comparative performance (including rates of failure and turnover) of minority and non-minority franchises.

Some of this information--for example, rates of failure--would be of immediate use to individual potential franchisees, while other information would be more relevant to enforcement of civil rights laws. In the case of at least some franchise restaurant chains, compliance with civil rights laws appears to require vigorous public and private enforcement. Mandates for enhanced

disclosure--as well as clarified or strengthened statutory prohibitions on discrimination--could significantly assist public and private efforts to address the continuing problems of discrimination against minorities in restaurant franchising.

"Minority Franchising: Is Discrimination A Factor?"

Testimony presented by Jacquelyn Gates,
Immediate Past National President
National Association of Negro Business
and Professional Women's Clubs, Inc.
to
Committee on Small Business
U.S. House of Representatives
Wednesday, June 30, 1993

National President - Catherine Sykes

69-853 O - 94 - 4

I. INTRODUCTION

Mr. Chairman, members of the House of Representatives Committee on Small Business, ladies and gentlemen...

My name is Jacquelyn Gates, and I am the immediate past national president (1987 - 1991) of The National Association of Negro Business and Professional Women's Clubs, Inc. I have been a member of this organization for twenty-eight years. My career has primarily been in the corporate sector, although I owned an executive search firm for two years in the late 1980's. Currently, I am the Vice President of Quality and Ethics for the NYNEX Mobile Communications Company in Orangeburg, New York.

Today, I am accompanied by the current National President of NANBPWC, Inc., Mrs. Catherine Sykes and our Executive Director, Ms. Ellen Graves. We appreciate the opportunity to share our entrepreneurial experiences and to give examples of how we as an organizational change agent were unable to overcome the obstacles that franchisers use to discriminate against minorities and women.

My testimony will give an overview of NANBPWC, Inc.'s history and its linkage to economic development, specific examples of the discriminating hurdles we encountered and some recommendations for the future.

II. History of NANBPWC, Inc.

NANBPWC, Inc. was founded in the spring of 1935. The founders were owners, managers, college graduates, and other professionally licensed women who had managed to realize some measure of personal success at a time when there was no national "movement" to improve the lot of black Americans; when there was no "black capitalism" program nor any black studies curricula. Still, they were ready to lead.

NANBPWC, Inc. members include thousands of busy, working women in 300 clubs in the United States, and Bermuda. We recognize the importance of sharing accomplishments with others and working together -- to improve the quality of life in our communities; to create an atmosphere in which black women are able to bring about meaningful changes in our public and private lives; to offer positive models to the young women in our communities; to share our skills and knowledge with others; to explore alternate ways for women to meet the multiple challenges of today's world.

On the local level NANBPW's 300 clubs identify and act upon the special needs of their communities. Workshops, programs and activities address a wide range of concerns:

- Employment and economic development
- Professional development and training
- Personal growth and development
- Health
- Divorce and child custody
- Housing
- Sex and race discrimination
- Working mothers
- Teenage pregnancy
- Community service
- Cultural enrichment
- Local, state, and national politics
- Child care initiatives including foster care programs
- Computer training

On the national level, NANBPWC, Inc.

- Enjoys observer status at the United Nations
- Provides a link with other national and international groups
- Co-sponsors technical assistance for government agencies, e.g., HUD
- Facilitates awarding of scholarships and financial assistance to college-bound students
- Conducts leadership training workshops
- Participates in international development programs including Africare
- Owns and operates the Nannie Jenkins Day Care Center -- Cuthbert, Georgia

III. Evolving Economic Development Initiatives

Historically, NANBPWC, Inc.'s economic development program thrusts have included the Nannie Jenkins Day Care Center founded to provide a safe and reliable child care program for women of this rural town in order that they could become gainfully employed outside of their homes.

NANBPWC, Inc. was the first national, black, female organization to own and operate a federal credit union, located in Silver Spring, Maryland.

During the 49th NANBPWC, Inc. Annual Convention held in August 1984, the membership voted to establish the NANBPWC, Inc. Economic Development Corporation, which was subsequently incorporated in March, 1985. The purpose of the EDC is:

- to expand opportunities available to black women who are substantially unemployed, under employed, whose income is below federal poverty guidelines or whose economic and educational opportunities have been limited due to prejudice and discrimination, economic and otherwise, to own, manage, and operate business enterprises;

- to assist minority women in developing entrepreneurial and management skills necessary for the successful operation of business enterprises; and to assist minority women in obtaining financial support from other sources;

- to raise the economic, educational and social levels of minority women;

- to foster and promote interest and concern for the problems of minority women and to foster and promote interest and concern for the problems of minority women to the end that economic and educational opportunities may be expanded and racial tensions, prejudice and discrimination, economic and otherwise, may be eliminated.

Individual members of NANBPWC, Inc. made financial contributions to initiate an EDC fund -- over $100,000 was collected initially. Members of the Economic Development Corporation's Board of Directors included NANBPWC Inc.'s President, First Vice President, Treasurer, Attorney and several members from each of six regional districts several of whom were franchisees (i.e., McDonald's, Kentucky Fried Chicken).

The Howard University Small Business Development Center and the accounting firm of Peat, Marwick, Mitchell prepared a comprehensive business plan which outlined the organizational structure, staffing requirements, capital requirements and proposed business ventures.

American Speedy Printing centers was identified as a viable franchiser with a special urban program to promote minority ownership of their franchises. The leadership of NANBPWC, Inc. in October, 1987 negotiated with American Speedy Printing Centers to serve as a conduit for identifying minority entrepreneurs for ownership of American Speedy Printing Centers franchise opportunities.

In February 1988, NANBPWC, Inc. became the proud owner of an American Speedy Printing Center at 1213 K Street in Washington, D.C. The center opened in July 1988 and NANBPWC, Inc.'s venture subsequently inspired members to open individually owned centers in Detroit, Michigan, Flint, Michigan, Greensboro, North Carolina and Queens, New York.

In order to grow the business and to provide technical assistance to NANBPWC, Inc.'s Board of Directors, an EDC Advisory Board was established in February, 1988. The members included executives from numerous corporations who demonstrated a commitment to minority economic development. The EDC Advisory Board Chairman was Mr. Jim O'Neal, Senior Vice President of Operations at Frito Lay Company. Other corporate members represent Ryder Systems, Inc., Boston Bank of Commerce, General Motors, IBM, The Wright Group, and Anheuser-Busch.

IV. Promises, Promises, Promises

American Speedy Corporation was founded upon a marketing plan which focused on a suburban profile. Shortly after their beginning years, they realized that the projected high growth arenas were in urban centers; hence their targeted urban program for minorities. They hired a credible African American, Andrew Pettress, whose responsibility was to lure potential minority franchisees into the business. His presentations were always dynamic and seemingly sincere. The reality was however, he had no power -- so his promises were usually not fulfilled. A few examples --

- he promised that American Speedy would underwrite a 1989 Business Women's luncheon ($5,000) at our national convention in exchange for an exhibit booth to promote its franchise opportunities -- result: debt unpaid;

- he promised that American Speedy would facilitate the funding process for NANBPWC, Inc.'s franchise since it had an "arrangement" with a dependable source -- result: the EDC President and myself, as National President, were required to sing personal promissory notes to fund equipment purchases, which left us undercapitalized;

- he promised that NANBPWC, Inc. would receive royalties for referred franchisees -- result: although five franchisees joined the system, only one $2,500 royalty payment was ever paid to NANBPWC, Inc.;

- he promised gratis external signage in exchange for free nationwide publicity that American Speedy received as a result of its relationship with NANBPWC, Inc. -- result: as of business closing in 1991, signage was never received, which had a negative impact on business;

- he promised comprehensive marketing plans -- result: marketing promotions were irrelevant to an urban market, especially in Washington, D.C. The absence of a targeted minority marketing plan also forfeited a niche opportunity for NANBPWC, Inc.

- he promised that in the event of business closing, American Speedy would assist in the liquidation of equipment -- result: NANBPWC, Inc. was forced to pay large sums to lease holders when negotiating the equipment returns.

V. Summary

NANBPWC, Inc. is a distinguished women's organization with a long-standing tradition and reputation spanning fifty-eight years. Our legacy is rich with visionary women who dared to go forth into unchartered territory.

To that end, approximately eight years ago, our leadership began a long, methodical search for an outlet for an economic thrust -- a natural step fulfilling a multi-purpose agendas, addressing education, opportunity and economic empowerment for our membership.

The search led us to American Speedy Printing Centers, Inc. This unique melding of vision and opportunity provided and challenge for all concerned.

We are all aware that new small businesses fail more than most in the first five years of operation. NANBPWC, Inc.'s unique business venture is unfortunately among the fatalities.

American Speedy Corporation benefitted from its relationship with NANBPWC, Inc. The publicity from our unique start-up, highlighted in over 400 newspapers, numerous national magazines, television reports and newsletters is publicity that could not be bought.

Additionally, we brought four additional franchises to the American Speedy table -- one which died in less than six months and three struggling to survive. We know that American Speedy did not value our franchises, and we know that if we were from the suburbs and/or traditional dominant culture, we would be in business today, or we would have been able to sell our business (whether thriving or failing) for a profit.

Again, thank you for the opportunity to share experiences.

WEDNESDAY, JULY 27, 1988 The Washington Times

MONEY

Black association buys franchise

By Pam McClintock
THE WASHINGTON TIMES

A professional organization of black businesswomen has purchased a franchise printing firm in downtown Washington, a venture designed to help its members and propel economic development in black communities.

The National Association of Negro Business and Professional Women's Clubs, which is holding its annual meeting in Washington this week, credits itself with being the first national association to buy a franchise.

"We think one way to boost our members up the economic ladder is via the entrepreneurial route. We believe our efforts will serve as a catalyst," said Jacquelyn Gates, president of the Washington-based national association.

On Sunday, Mrs. Gates was present for the grand opening of the American Speedy Printing Center in the 1200 block of K Street NW. After establishing a co-venture with American Speedy Printing Centers Inc., the professional association put up $39,000 to acquire the Washington franchise, Mrs. Gates said.

The money was raised from contributions, she said. The association represents more than 12,000 black women nationwide.

"They did it. They put their money where their mouth is. Everybody is talking about economic development. But they've exercised the kind of leadership needed to make economic development a reality in America," said Andrew Pettress, urban franchise development director for American Speedy Centers.

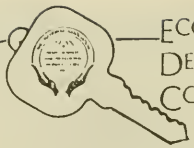
American Speedy Centers, based in Birmingham, Mich., has 500 franchises across the country, including several other centers in the metropolitan area.

The newest Washington franchise will serve as a model for other groups and associations, Mr. Pettress said.

Mrs. Gates said the new business already has inspired five other members from across the country to think about purchasing a franchise.

Mrs. Gates said her organization did extensive research before deciding what kind of franchise it wanted to buy, and that the decision to purchase an American Speedy Printing Center was made with help from Howard University and the accounting firm of Peat, Marwick & Mitchell.

"It's a major risk because it's never been done. But we are an organization that has a number of firsts in our history," she said.



ECONOMIC DEVELOPMENT CORPORATION

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Birmingham, MI 48010
313-645-6333

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Gen. Dir. of Personnel Administration
GENERAL MOTORS CORPORATION
3044 West Grand Boulevard
8th Floor - Room 269
Detroit, MI 48202
313-556-3170

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Purchase, NY 10577
914-697-6733

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Board of Directors
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Riviera Beach, FL 33404
305-844-4197

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of Corporate Affairs
ANHEUSER-BUSCH COMPANIES
1 Busch Place
St. Louis, MO 63118
314-577-2000

Mr. Carter Womack
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Action & Equal Opportunity Programs
RYDER SYSTEMS, INC.
3600 NW 82nd Avenue
Miami, FL 33166
305-593-4573

Mr. Charles Wright
Vice Presient
COPPIN STATE COLLEGE
2500 W. North Avenue
Baltimore, MD 21216
301-333-5960

Mr. Ronald A. Homer
CEO/President
BOSTON BANK OF COMMERCE
110 Tremont Street
Boston, MA 02108
617-423-1010

Mr. Jim O'Neal
Senior Vice Pres. of Operations
FRITO LAY CORPORATION
P.O. Box 660634
Dallas, TX 75266-0634
214-353-3852

Ms. Jacquelyn Gates
National President
NAMBPWC, INC.
7451 NW 41st Court
Lauderhill, FL 33319
305-484-6933

Ms. Margaret Belcher
President
ECONOMIC DEVELOPMENT CORPORATION
2861 Urban Avenue
Columbus, GA 31907
404-926-6410

American Speedy Printing Centers and the National Association of Negro Business & Professional Women's Clubs are celebrating a milestone: The NANBPWC became the first association to buy a franchise when they purchased an American Speedy franchise.

JOIN THE CLUB

For the first time in franchise history, an association has purchased a franchise. The National Association of Negro Business & Professional Women's Clubs Inc. (NANBPWC), a 55-year-old organization boasting more than 11,000 members, opened a Washington, D.C branch of American Speedy Printing Centers in July 1988.

With the objective of helping its members break into the economic power structure, the Washington, D.C.-based NANBPWC first conducted extensive research into American business which showed that entrepreneurship was on the upswing nationwide and, therefore, was the best avenue not only for the group members, but also for the association itself. "We think one way to boost our members up the economic ladder is via the entrepreneurial route," explains Jacquelyn Gates, national NANBPWC president. "We believe our efforts will serve as a catalyst."

However, the association didn't jump on the entrepreneurial bandwagon without first researching all the business opportunities available. "We had consultants from Howard University and a presentation from Peat, Marwick & Mitchell accounting firm," Gates explains, "and all the information pointed at printing and franchising as the best entrepreneurial route."

After the association had decided on printing, they again investigated the top franchise operations before deciding to buy an American Speedy Printing Center. Gates recalls, "Frankly, American Speedy responded to our inquiries with more enthusiasm and was more receptive to what we were trying to do than any of the other alternatives."

"American Speedy responded to our inquiries with more enthusiasm and was more receptive to what we were trying to do than any of the other alternatives."

The Association's business relationship with American Speedy has already proven productive. According to Andrew Pettress, American Speedy's director of Special Market Development, six association members will soon be opening their own American Speedy Printing Centers.

The franchise relationship between the NANBPWC and American Speedy is serving dual purposes, according to Gates. "Our goal, very simply: To improve black communities by providing more jobs through our association members who become business owners. That in a nutshell is what the 'economic development' movement is all about." ■

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22 VENTURE NOVEMBER 1988

FASTFACTS

A New Spin

Oasis Laundries Inc. hopes to wash away lackadaisical service in its i by franchising its upscale laundromats across the country. At any laundromat—currently 11 franchisees and one company-owned unit in th Francisco Bay Area—patrons enjoy snack bars, movies on big-screen video games, and tanning booths in between fluffing and folding.

President Cor Bregman prides himself on keeping outlets clean, comf able, and colorful—a concept not exactly the norm at neighborhood mom-a pop laundromats. The current lack of attention to customer service a amenities," he says, makes for a great franchising opportunity. Oasis w founded in January 1987, in San Jose.

Oasis charges a franchise fee of $25,000 and estimates that it takes a tot initial investment of between $233,000 and $370,000 to launch a laundromat. Bregman hopes to have 15 units open by yearend and 65 by yearend 1989. In 1987 Oasis posted a net loss of $449,000 on system-wide revenues of $135,166. This year Bregman projects a pretax profit of $369,000 on $3.4 million in revenues. —*Gail Ignacio*

A Helping Hand

The National Assn. of Negro Business and Professional Women's Clubs Inc. (NANBPWC), through a joint venture with American Speedy Printing Centers, has become a franchisee—the first association to take that step. NANBPWC, a nonprofit organization in Washington, is helping members finance the $39,500 franchise fee for an American Speedy franchise through its Economic Development Corp. (EDC). To date special member donations have raised about $100,000. While prospective franchisees are recommended to American Speedy by EDC's advisory board, they still go through the company's regular selection process.

According to Jacquelyn Gates, president of NANBPWC, the group wanted to help members break into quick-printing franchises because of their hot growth potential and chose American Speedy because of its warm response. Andrew Pettress, American Speedy's urban franchise development director, expects the co-venture to produce at least 15 franchise outlets in the next few years. One franchise already is open in Washington and four more are in the works. —*C.I.*

On the Move

Travelhost Inc., the Dallas-based operator of a 2,200-member independent travel agency consortium and publisher of *Travelhost Magazine*, has launched a new company, Travelhost Agencies Inc. (TA), to franchise travel agencies.

Citing the boom in post-deregulation air travel and Travelhost's 21 years of experience in the travel industry, TA President Robert E. Thomas says he plans to open 1,000 franchises by 1993. He says TA has been focusing on travel agency start-ups since launching the franchise program in May but will have a conversion package for existing agencies in 1989.

Franchisees will pay a $42,900 fee and another $35,000 to $80,000 in initial costs. The fee covers a week's training, use of the Travelhost name, advertising, and furnishings. Each location will be set up with a VCR and a TV so clients can view videos of possible vacation spots. An additional weekly fee of $175 includes access to the company's computer reservation system and additional advertising programs and training. "We want to be the most influential name in travel," says Thomas. —*G.I.*

ILLUSTRATION: RICHARD LOOSIO

Women Achieve With American Speedy

By Lisa Maggard, Director of Communications, American Speedy Printing Centers, Inc.

Charlotte Dieckhoff
Elizabethtown, Kentucky

"I love it," says Charlotte Dieckhoff, when asked to describe how she likes being owner/operator of her American Speedy Printing Center in Elizabethtown, Kentucky.

The part she likes best, she says, is how it has broadened her scope as a person, and "I like dealing with people, getting to know people I would never have known before, being involved in the community."

Ms. Dieckhoff worked in industrial sales before she married and had children, and it was after her children were school age that she started looking for career-change options.

"I went back to school and studied computers and systems analysis before I started looking at business opportunities." She investigated a number of franchise opportunities before deciding on American Speedy. "I liked the kind of people they were," she says, "a young, aggressive group."

One of the things she says she likes best about her American Speedy franchise is "the feeling I'm building something for my children, security for the future."

Eileen Rogers
Scottsdale, Arizona

"I believe in the 'American Dream'," says American Speedy franchise owner Eileen Rogers of Scottsdale, Arizona. "I'm 27 years old, and I made $50,000 last year. I think my story proves you can have the 'American Dream' if you want it and you work hard."

Ms. Rogers moved to Arizona 4½ years ago after graduating from The University of Wisconsin. She knew no one and had only $200 when she drove into Scottsdale.

"One of the first places I stopped was an American Speedy Printing Center to have my resume printed," she says.

Ms. Rogers met the owner of the Center, and their conversations eventually led to an arrangement whereby she went to work for the Center, earned a 20% interest in the business by increasing sales 20% over a one year period, and earned the right to buy another 20%.

"We like people. That's why we have done so well," she says. "I don't sell printing," she says. "I just help people; I share my knowledge. Seventy percent of our business is referral from people who are pleased with the quality of our work and service.

"I'm a real supporter of the American Speedy franchise system," she says. "I utilize the help and support that's available there, and the equipment discounts help a lot."

Ms. Rogers believes the greatest value to her from American Speedy is the name. "The resale value is a lot greater with a national name. Our business wouldn't be worth nearly as much if we were just 'Brian and Eileen's Print Shop'." □

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TESTIMONY BEFORE THE
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS

"MINORITY FRANCHISING: IS DISCRIMINATION A FACTOR?"

June 30, 1993

Joseph E. Sánchez, Jr.

I would like to thank you, Mr. Chairman, and the members of your Committee for the opportunity to share with you my experiences as a former minority franchisee of the McDonald's Corporation.

For the record, my name is Joseph E. Sánchez, Jr. . I am an Hispanic-American. This statement is based upon my experiences as a franchisee of the McDonald's Corporation from the period of June 1985 through September 1991. During this interval I experienced a series of discriminatory practices initiated and carried out by McDonald's corporate and local regional employees. These abuses and resulting issues are unresolved and are presently being addressed in the Federal Court System. I am accompanied here today by my attorney, Mr. David Aronofsky, who will answer any questions the Committee may have relative to the legal issues of my case.

My testimony is submitted in response to the request by the Committee for information concerning racially discriminatory conduct encountered by minority entrepreneurs after purchasing and operating a franchise.

This testimony addresses issues which include: (1) limited opportunities for minority franchise ownership and expansion within the McDonald's system, (2) steering of minority franchises within McDonald's to low income, depressed or minority communities while reserving more lucrative locations for non-minority franchisees, (3) discriminatory pricing and leasing policies by McDonald's which impose higher operating costs on minority owners, and (4) use of arbitrary or discriminatory grading systems and other tactics by McDonald's to limit expansion opportunities for minority owners.

In 1985 I entered the McDonald's system as a franchisee in Houston, Texas. Although originally from the Washington, D.C. metropolitan area, I was told that the only available opportunities were in the Southwest area of the country. That area has a large Hispanic population. I was advised by McDonald's to apply for a franchise in the Houston, Texas area where my father, Joseph E. Sánchez, Sr. had

been operating as a McDonald's franchisee since 1978. He, too, had to move from the Washington, D.C. area because of a purported unavailability of franchise opportunities in the lucrative Washington/Baltimore region.

Notwithstanding my family history with McDonald's, my entry into the system in Houston was far from smooth. McDonald's initially recruited me to Houston, Texas with the verbal offer of a brand new restaurant in a relatively affluent suburban neighborhood. When I arrived in Houston however, this new restaurant suddenly became unavailable because McDonald's corporate representatives said "the site would not be good for me." Instead I was placed in a far less commercially desirable restaurant on an "interim" ninety (90) day basis until another restaurant became available. This "interim" period lasted some fifteen (15) months and resulted in significant personal financial losses because of the poor restaurant location and physical condition of the facility.

While operating this restaurant, I received unwarranted criticism and negative evaluations by McDonald's corporate personnel for allegedly employing too many African-Americans and Hispanics. This was presented to me as being a violation of McDonald's "Representative Work Force" policy which McDonald's selectively applies to prohibit operators from hiring individuals who do not adequately reflect, what McDonald's calls, the "proper" racial mix in the community and restaurant trading area. Despite orders to fire many of my African-American employees, I refused to do so. From that point on my career with McDonald's headed down hill.

After expending considerable money and effort on the "interim" restaurant, I finally received a more permanent restaurant location in July of 1986. In this new location I worked with my employees to excel. And excel we did. We won the "Outstanding Store," "Outstanding Manager" awards in two consecutive years (1987 and 1988). I bring this point up because it clearly indicates that my operations were far above the norm. I was never willing to be labelled as a mediocre operator merely because of my minority status.

Despite my outstanding performance, I was deemed unexpandable i.e. ineligible to acquire any additional restaurants because McDonald's uses totally arbitrary criteria to deny an operator more restaurants. In my situation, they cited financial problems. They knew that any financial problems that I had were directly attributable to the excessive $15,000 per month rent I was required to pay on the new restaurant. Add to that the substantial renovation costs incurred for the "interim" restaurant and it was a no win situation for me from the start. Tellingly, the non-minority franchisee who ultimately took over my Houston restaurant received an immediate rent reduction to $6,000 which, if I had been given the same

rent my financial problems would have been non-existent.

My efforts to keep the "interim" restaurant on a temporary basis to generate cash flow needed to cushion the restaurant's opening that was greatly below McDonald's own projections were met with McDonald's corporate refusal. In fact I was subjected to a series of unannounced inspections which resulted in "F" operational grades during this time, a result subsequently overturned in an ombudsman proceeding which awarded me all "B" grades.

My attempts to work out my problems with the local McDonald's corporate management personnel proved unsuccessful, and I soon began encountering various forms of racially offensive treatment within the Houston region. Following are a few such instances:

a.) When I started becoming active in the Houston advertising cooperative organization for the purpose of seeking formal African-American and Hispanic representation, I was told by McDonald's corporate personnel plus other non-minority Houston franchisees on the organizational board that Hispanics lacked the "intellectual capability" to contribute to the organizations policies.

b.) After I called meetings of the Houston minority franchisees to seek better treatment, I was told that my restaurant "had the highest number of complaints in the region" even though no documentation of this was ever provided. This came from the regional management level while at the same time my McDonald's field consultant was apprising me of my positive attitude and excellent overall restaurant ratings.

c.) My bilingual management personnel were refused entry into a number of local McDonald's training programs because the McDonald's instructor was afraid that their accents would impede the progress of the class.

d.) I continued to be deemed un-expandable for new restaurants even though non-minority franchisees who entered the system and the Houston region at the same time as I were receiving additional restaurants; and though these non-minority franchisees had operational ratings similar or even inferior to mine. In addition, the non-minority franchisees in Houston were receiving various forms of special financial assistance such as low or no interest loans for capital improvements, and special low rent structures that were denied me.

It finally became apparent to me as the result of McDonald's refusal to let me expand and the many forms of racially directed abuse I was experiencing from McDonald's corporate personnel I had to get out of Houston.

With regard to my non-expandability there, I subsequently learned from one of my former key employees that the policy of the top McDonald's corporate officer in Houston was to restrict the number of Hispanic franchisees and the number of Hispanic owned franchises since there were plenty of Hispanic franchisees in other parts of Texas such as the Rio Grande Valley and San Antonio. I make this point because I think the Committee should now that when I went to Houston in 1985 I was the third (3rd) Hispanic franchisee with a total of only five (5) Hispanic owned restaurants including mine in the Houston metropolitan area. Today, eight (8) years later, there still is only three (3) Hispanic franchisees and one of those will be leaving McDonald's at the end of July, leaving a total of merely six (6) Hispanic owned franchises. I cite these statistics because the same metropolitan area has over one hundred and forty (140) McDonald's restaurants owned by more than forty (40) franchisees. The 1990 United States census data demonstrated that the Hispanic population of Houston exceeds 25% (enough to require a new Hispanic Congressional District). As you can see Hispanics are grossly underrepresented in Houston. McDonald's has not welcomed Hispanics or Hispanic franchises in Houston.

In the summer of 1989 I received an opportunity to purchase a McDonald's restaurant in an area of Baltimore, Maryland called Park Heights/Pimlico. Although McDonald's licensing personnel told me there was only one restaurant available at the time, McDonald's personnel also told me that I would receive a second nearby restaurant planned for construction when it was finished. After I was in the restaurant for about a year a top McDonald's corporate officer in Maryland told me that I had been offered the Park Heights/Pimlico restaurant only because I was a minority. I subsequently learned from a McDonald's Baltimore executive who was forced to resign under seriously debilitating financial terms for trying to solve my problems with McDonald's that McDonald's had in fact misrepresented the facts about available restaurants in the Baltimore area at the time I was trying to move there. It turns out there were other Baltimore area restaurants available for sale in the general time period I sought to relocate, but they were in white suburban areas and "reserved" for white operators.

It was only on the basis of the McDonald's licensing manager's assurance of the second restaurant and future cash flow assertions provided by McDonald's did I agree to purchase the restaurant in Baltimore.

My transfer to Baltimore was initially promised by a McDonald's corporate officer to be an even exchange of assets value from Houston to Baltimore. At the eleventh hour I was told that I would be required to pay an additional $200,000 for the Baltimore restaurant because of projected greater sales than the Houston restaurant. Further, I was told via a tape recorded voice mail message from the McDonald's Houston regional licensing manager that (1) I had to find a buyer for my Houston restaurant before I could even be considered for the Baltimore restaurants, contrary to what the McDonald's local regional manager had assured me; and (2) on the apparent basis of neighborhood trading area racial demographics I could only sell my restaurant to an Anglo or Hispanic, but certainly not to a Black individual.

The Houston regional office then proceeded to send two potential, non-African-American, "buyers" to see me. These buyers, however, indicated that they would not pay the price for the Houston restaurant which had been established by the Houston regional manager, not by me. I was not permitted to negotiate a sale price. My father then called the McDonald's regional manager to inquire about purchasing the restaurant. Despite the fact that my father owned several successful McDonald's franchises in the Houston area, he was flatly refused with an earlier explanation that I had been given - "the restaurant would not be good for you."

Both concerned and outraged about the message left by the McDonald's Houston regional licensing manager, as well as the subsequent actions suggesting that race would be a factor in determining restaurant approval by the McDonald's corporate personnel, I made a copy of the recorded voice mail message (received on McDonald's communications system) and sent it to the president of McDonald's in Oak Brook, Illinois. I was assured by the president that the matter would be investigated. This investigation never occurred. McDonald's president's overriding concern seemed not with addressing the underlying racism implications of the voice mail message but instead with covering up the incident since he wanted to know specifically who else knew about the contents of the voice mail message.

After my conversation with the president of McDonald's I received a call from a McDonald's corporate staff director for affirmative action who acknowledged the Houston's region's discriminatory practices against Hispanic operators by commenting that "you have to know how to operate in this white man's company."

In the meantime, I was unable to find a "suitable" buyer for my Houston restaurant and was forced into exchanging it for the Baltimore restaurant to keep from losing the latter. As a condition for the "exchange," McDonald's required me to borrow several hundred thousand dollars, $200,000 of which was an additional

payment for the Baltimore restaurant because of misrepresented higher cash flow and the alleged resulting value increase.

After moving to Baltimore I was reassured immediately by the local McDonald's regional manager and the field service manager that I would be awarded my soon to be built restaurant less than a mile from my present location. Shortly thereafter, McDonald's Baltimore and corporate personnel officials told me that I had to maintain a 100% African-American work force because the Park Heights/Pimlico neighborhood demographics were purported by McDonald's to be 100% African-American. I was told that if I didn't follow this direction and if sales decreased as a result of my employment practices that McDonald's "would come into the restaurant and straighten things up." Needless to say I objected because this would have required me to terminate my few non-African-American employees, including some Hispanic individuals I brought from my Houston restaurant with me. Later I attended a Baltimore City Mini-Market meeting of McDonald's franchisees operating restaurants within the city boundaries, where I actively sought increased advertising emphasis directed to our community customer base. After this meeting, which was attended by McDonald's regional personnel, I was warned by the regional manager not "to cause trouble" by trying to market too aggressively to the inner city customers and by associating with the African-American McDonald's franchisees in Baltimore.

Within four (4) months of arriving in the Baltimore region I was told by the regional manager to hire and begin training staff for my soon to be built restaurant. I promptly responded by investing in hiring and training staff on the reliance of McDonald's direction. In June 1990, when I was driving by the site of the new restaurant enroute to the one I was operating, I observed that construction activity had commenced. I immediately called the regional manager and asked why I was not consulted on the decor and other details related to the construction of the restaurant. He did not respond, but had the regional personnel manager call and tell me that the new restaurant was going to be a McDonald's Corporation operated restaurant. The regional personnel manager told me I shouldn't complain because Hispanics in McDonald's had to be subservient to succeed.

Let me briefly share my experience as an inner-city McDonald's franchisee in Baltimore, Maryland. During my eighteen (18) months in the Park Heights/Pimlico area my restaurant was robbed numerous times; drug use and abuse in and around the restaurant forced me to employ special restaurant security to deal with the problem. Vandalism and destruction of the restaurant's physical premises and furnishings occurred so frequently I could not keep track of all such incidents. Ironically, when I was trying to decide to move to Baltimore, McDonald's corporate

personnel indicated that the restaurant had little if any crime problem and I had no reason to doubt this at the time since I was not from the area.

As if things couldn't get any worse, I also learned, after reviewing an internal corporate memorandum, that accounting personnel at McDonald's corporate headquarters were advising all regional accounting personnel that the figures in McDonald's *Pro Forma* projections used to calculate restaurant value and future cash flow were not accurate. The reliability of the financial data supplied by McDonald's representatives and relied upon by me and my bank to purchase the Park Heights/Pimlico restaurant was therefore unwarranted. On the basis of all of these developments, I concluded that very little of what I had been told by McDonald's® was credible.

In December of 1990 I began hearing from other Baltimore area franchisees and the McDonald's regional personnel manager that the regional manager considered my ownership of the Park Heights/Pimlico restaurant a mistake because I (according to the regional manager) was the "type" of franchisee who needed to be in a "white neighborhood." Also during this time period, I and my wife, Cathy, met with the regional personnel manager and it was at this meeting that we learned for the first time about the franchise's prior history of employee and customer drug problems plus crew theft plaguing the restaurant prior to my purchase. It was actually referred to within the regional McDonald's office as the "O.K. Corral." We then met with the regional manager to discuss all of the promises he had made and subsequently broken. To our shock the regional manager indicated he was totally ignorant of all of the prior problems at the restaurant. When my wife complained to the McDonald's regional manager that she was unable to work in the restaurant because of the extremely violent criminal activity, the McDonald's regional manager told my wife that if he had known the color of her hair (my wife is blonde and fair skinned) he would never have placed me in that restaurant. After meeting with my wife, he offered to put us in a "white neighborhood." Further the McDonald's regional manager said that if there was an Hispanic neighborhood in Baltimore he would have placed me there, but since there weren't any, he stated I was placed in the Park Heights/Pimlico restaurant solely on the basis of my minority status.

Our last meeting with McDonald's Baltimore regional personnel took place in January of 1991. I again was joined by my wife and during that meeting, the regional field consultant made a statement that "as a white man, I felt really uncomfortable in your store." The regional manager again stated that I had to be "put into a white restaurant." Let me make clear to this Committee that I strongly objected then and strongly object now to the view that franchises be awarded to anyone strictly on the basis of racial criteria even though I believe in the need for

aggressive affirmative action where this is necessary to correct past discriminatory franchisor actions. My point here is that I found McDonald's whole approach to awarding me or anyone else a franchise on the basis of my ethnic background or my wife's hair color to be offensive.

Soon after my January 1991 meeting, my attorneys decided to write McDonald's and request a amicable financial resolution of my problems by proposing to sell my Baltimore restaurant at its fair market value and leave McDonald's because I had concluded I couldn't remain as a franchisee. As had been their practice in the past, however, McDonald's continued its failure to deal in good faith. All I wanted to do was to sell the restaurant to payoff the bank loan McDonald's required me to get in the first place to purchase the Baltimore restaurant plus all the debts I had incurred in my move to Baltimore plus the incremental equity value resulting from the sales increases I had managed to generate in my first year of business in Baltimore. Instead McDonald's offered a sales price nearly $150,000 below the bank note I had signed to buy the Baltimore restaurant and pay McDonald's the additional $200,000 required to move to Baltimore. I eventually had no choice but to file a lawsuit in the Federal Court System in July 1991 and voluntarily left the McDonald's system in September 1991 after years of subtle and overt ethnic and racial abuse.

Contrary to the "policies" espoused and touted by the McDonald's Corporation the reality of the following minority abuses existed and were experienced during my years within the system and they exist and are continuing to be experienced by minority operators today:

a.) Clustering, redlining and steering <u>most</u> minority franchises to their own race and ethnic communities while lucrative locations are reserved for non-minority operators. Regional restaurant ownership statistics speak louder than the "plans" and "policies" of McDonald's. Do minority licensees own and operate an <u>equitable</u> share of the high sales volume and high profit restaurants within the system? Contrary to the constant "rhetoric" from McDonald's the concentration of minority ownership is disproportionately limited to low sales/low profit restaurants.

b.) Intentional price discrimination in the formulation and charging of restaurant franchise purchase prices and subsequent rental rates charged to minority franchisees, resulting in significantly higher purchase price and rent per food sales dollar for minority franchisees than for non-minority franchisees.

c.) The ongoing use of discriminatory and arbitrary grading systems as a means to engage in active intimidation of any minority franchisees who openly question the discriminatory practices of McDonald's.

d.) Bait and switch tactics to trick minority franchisees into accepting overpriced, inferior facilities and restaurant locations. These activities are calculated to intentionally re-franchise hopelessly unprofitable sites.

e.) Arbitrary, discriminatory and capricious evaluation and grading procedures designed to limit the expansion potential and capability of minority operators.

Why hasn't there been a ground swell of complaints from the McDonald's minority operator community? The answer is very simply -- FEAR. Fear of vicious retaliation. Fear of losing their businesses. Fear of losing everything that they have worked for. What I consider to be designed and calculated indentured servitude, McDonald's has placed a substantial number of minority operators in the position being both a franchisee and a borrower. Poor locations, with high operating costs and low profits have forced minority operators to seek financial help from the lender of last resort, McDonald's. Contrary to what McDonald's management calls a "partnership," this biased business relationship by its very nature, limits any and all forms of protest, complaint, and criticism. If protest is attempted by anyone within the minority operator community, swift financial retaliation is the response from McDonald's who is both the franchisor and lender. Additionally, minority operators are coerced into their silence or "false" system support with the promises of additional restaurants or other financial inducements. Further, minority operators (and McDonald's former minority employees) are forced to sign release agreements strictly prohibiting them from pursuing any form of legal action to redress claimed Federal Civil Rights violations by McDonald's.

Mr. Chairman, you may hear that the testimony I give to you and the Committee this morning is non-representative, and that it only depicts isolated problems experienced by a disgruntled former licensee. But on the contrary, my views are shared by other Hispanic operators who are still within the McDonald's system. A summary of concerns was formulated during a meeting (which I did not attend) by the governing body of the McDonald's Hispanic Owners' Association (MHOA). This board of regional spokespersons represented the views of over one hundred and fifteen (115) Hispanic operators. These concerns were documented in the form of organizational minutes dated September 21, 1991 and are attached here. A representative sample of the concerns raised by this board which addressed McDonald's racially biased practices are listed as follows:

a.) "Regional managers abuse, [they] are insensitive to Hispanic Owner/Operators and their issues. (no respect!)"

b.) "Redlining of Hispanic Owner/Operators - not equal access to all areas."

c.) "[Lack of] store expansion of existing Owner Operators.

d.) "[Lack of] upward mobility in McOpco (McDonald's operated restaurants) for Hispanic employees - No follow-thru with Hispanic employees at all levels.

e.) "Hispanic advocate in Oakbrook (who is it and who will it be in the future)"

f.) "New Hispanic Owner/Operators [are] placed in markets with limited growth potential."

g.) "Double standards in multiple store awards/financing. Double standards in expansion criteria."

h.) "McDonald's cherry-picking of stores (equality/fairness)"

i.) "[McDonald's] Oakbrook [headquarters] - preferential treatment on store sales."

j.) "Retribution for past conflicts with Regions or Regional managers."

k.) "Lack of parity in the [McDonald's] system for Hispanic employees - entry level jobs, sponsors, mentors, etc."

Mr. Chairman, as you can see in the foregoing, the abuses I have raised this morning aren't a fabrication of a former minority licensee. The problems are real and in response to McDonald's corporate statement that "its relationship with its franchisees is the best in the industry" (Quinlan/Rensi letter to U.S. franchisees dated April 7, 1993) they must be addressed and resolved.

New legislation for equality and fairness in franchising is needed. Legislation addressing these issues must include requirements for franchisors to make full and complete disclosure to prospective franchisees regarding sales history, sales ownership, projected sales impacts of any planned units in the surrounding market

trading area, sales projections for franchise locations, and other pertinent facts which could affect the restaurants's sales activity and value. Also, there should be a prohibition against unfair trade practices in franchising, such as churning, bait and switch tactics, and price and rent discrimination. In concert with this legislation, the Federal Trade Commission should have the authority to engage in rule-making and be able to conduct investigations to enforce future franchising legislation. Further, I feel an anti-discrimination statute to outlaw redlining and clustering of minority franchisees with strict legal penalties is required. These steps will go a long way towards achieving fairness in the franchising process.

In closing, Mr. Chairman, I would like to again thank you and the members of the Committee for extending an invitation to me to speak before you on the issue of discrimination which does exist in minority franchising. I wish you success in your legislative endeavor.

ASIAN AMERICAN HOTEL OWNERS ASSOCIATION (AAHOA)
AND
AMERICAN FRANCHISEE ASSOCIATION (AFA)
Statement of Nitin Shah
Chairman of Board Of Directors of AAHOA
Member of Executive Committee of AFA

BEFORE THE CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS
June 30, 1993

Mr. Chairman and Members of the Committee:

My name is Nitin Shah, I am the Chairman of the Asian American Hotel Owners Association and a member of the Executive Committee of the American Franchisee Association.

It is indeed my privilege to address this House Committee on Small Business hearing entitled, "Minority Franchising: Is Discrimination a Factor?" After a brief description of what these two associations are and do, I will get to the key issues identified in this hearing, I will comment on vital issues and problems that Minorities face before and after purchasing and operating a Franchise. I will also comment on other issues relating to Franchising that affect all Franchisees. Finally, I will make recommendations as to actions the committee might take to ensure fair Franchising.

The Asian American Hotel Owners Association is a non-profit organization. It was established in 1990, primarily to address the issues of discrimination, institutional bias, stereotypes and stigma that many Asian hotel and motel owners faced in the Hotel industry, especially from some Franchisors, lenders, travel organizations that grade hotels, vendors, and insurance companies that affect the economic viability and some time, the very survival, of the many Asian hotel and

motel owners and operators.

As of today we represent approximately 1,500 hotel owners owning almost 7,500 small and medium size motels including Franchised Hotels and independent hotels. While we have made many strides in areas of discrimination and other issues through this organization, a lot remains to be done.

Recognizing that all minorities face similar obstacles and problems that we face in the hotel industry and are prevalent in all franchised businesses, realizing that the Franchisors are too strong, individually and collectively, to force any change single handedly, our Association decided to become a founding member of the American Franchisee Association (AFA).

The AFA was founded earlier this year to :

- Represent and address problems facing Franchisees in all industries in the development of Franchising and its fair regulation by the government.
- Educating Franchisees, potential Franchises, the government and public as to the needs and issues facing Franchisees.
- Protecting, improving and enhancing the business conditions and economic investments of Franchises.

As of today, the AFA represents 10,399 Franchised outlets owned by over 5,200 Franchisees in fourteen different industries.

Now, in keeping with the issues identified in this hearing, the following are some of the issues that we think pose a major challenges to us as a minority Franchisee.

1. DIFFICULT ACCESS TO MINORITIES IN MANY FRANCHISE SYSTEMS:

Several prominent Franchisors work hard to help minorities in becoming

Franchisees and with promoting equal access to their system to them; however, there are other Franchisors who once they find out that the applicant is an Asian or other minority, they either deny or make it extremely difficult to obtain their Franchise for the particular site or location.

How do they deny or make it difficult to get a Franchise? The reason given for the denials vary depending on the situation but the following reasons are the most commonly used.

a. Your financial standing is not adequate.

b. You do not have management or Franchise operations experience.

c. You do not have established credit.

d. Your location is not our target market.

e. You do not meet our Franchising criteria.

Consequently, it is extremely difficult—if not impossible— to prove that your application was denied on the grounds of bias or discrimination or for the reasons other than stated.

Often they impose rigorous requirements or process an application so slowly that either the minority applicant loses interest or he/she loses their financing or location commitment. In many cases they would not accommodate or make certain exceptions to their requirements which they might make for other Franchisees.

I do want to emphasize that if traced, a double standard can be seen. A minority applicant has to go through an excruciating process that other applicants do not have to endure to get a Franchise application approved.

For example: You might be interviewed by five to ten department heads before you are approved or they may ask you put a large deposit in escrow for future royalty payments, thus changing the financial burden for minorities.

Due to their reluctant approval, a minority Franchisee loses any or all chance to negotiate for a fair agreement and terms. After purchasing the Franchise, there always remains a constant fear of reprisals -- "What will the Franchisor do?" -- which can put a fatal blow to the economic viability of the business.

2. INCONSISTENT SELECTION CRITERIA FOR NEW FRANCHISE:

When it comes to minorities, many Franchisors apply different and inconsistent criteria for the selection of a Franchisee, especially when two or more applications are received for the same location. While it is always difficult to prove it, there is a feeling in the minority community that, if given choice, they are the last ones to be chosen to the get the Franchise.

On a good site selected by a minority Franchisee, a Franchisor encourages other Franchisees in the area to apply for the Franchise and then deny the minority by stating that the existing Franchisee has a pending application or has the first right to refusal. Thus, locations that minorities generally get are secondary locations where someone else has already failed, or in the inner cities or towns where no one else wants a Franchise.

3. ARBITRARY AND BIASED APPLICATION OF IMPACT OR ENCROACHMENT POLICIES:

Few Franchisors have written Impact or Encroachment policies, even though they are the most controversial issues facing all Franchisees. These impact policies are applied arbitrarily and inconsistently, especially when it comes to the minority Franchisee.

Many Franchisors work with superior knowledge. They know about the limited resources, knowledge and ability of existing minority Franchisees to fight an encroaching application for a new outlet. The result is often the approval of

Franchises of preferred applicants in close proximity of a minority owned Franchise outlet. The Franchisors also know that many minority Franchisees lack financial resources and wherewithal to fight the protracted legal battle required to win an Impact issue. If one does fight the Franchisors salaried legal staff can harass and fight the minority Franchisee to the point that they give up, and that, of course, is the Franchisor's goal.

Franchisors run their own complicated, sophisticated market analyses prior to putting up any new outlet. They know if new construction will impact by X%, if new management will impact by X% or if the proposed new unit will impact by X%. Franchisors are not telling the whole truth when they say that you cannot prove impact.

There is a feeling in the minority community that the reverse is often not true. For example, when and if, the same application were made by a minority applicant with the existing encroached Franchisee not being a minority then the minority application would be rejected or not treated fairly or equally.

Because there are so many factors involved when determining an impact issue, it is extremely difficult for Franchisees to prove such claims without almost limitless financial resources.

Franchisors further claim that impact is a qualitative analysis. They claim there is no way that anyone can show or prove that the impact caused to an existing Franchisee can be measured in percentages as close as 3 percent of the revenue. Afterwards, if your revenues are reduced by less than 3% they consider it does not impact the existing Franchisee. We disagree with this because in any impact regardless whether it is 3% or less or more than 3%, it is an impact. The margin of error in any statistical data is 3 to 5 percent. How can any one judge a 3% impact?

4. DIFFICULT TRANSFER OF AN EXISTING FRANCHISE:

In many circumstances when a minority purchases an existing Franchise, the Franchisor often imposes tougher standards of quality assurance or renovation, higher royalty fees, higher transfer and other fees to the minority applicant. In most circumstances the Franchisor will not let you assume an existing Franchise agreement. Instead, they make the Buyer sign a "then current" Franchise agreement which is more stringent and often more expensive.

The Seller can not get out from the existing Franchise agreement without paying large liquidated and other damages, and the minority Buyer has no choice if he wants to purchase the business. The existing Franchisee has no alternative but to accept all the new terms and conditions of the Franchisor or lose the deal.

In many instances the Franchisor knows that the lender of a prospective Buyer will condition the financing on the continuance of the Franchise and that Buyer has no other choice but to accept the Franchise with whatever conditions the Franchisor may impose. In many cases the Franchisor sees the transfer as an opportunity to exercise extraordinary rights.

For example, in the hotel business, if you sell your Franchised hotel, most of the Franchisors require a "Product Improvement Plan" to extensively renovate your property regardless of whether it is needed at the time or not. However, this means the new Buyer must expend large sums of money to completely renovate the property. At times, funds for such renovations are required to be put into an escrow account. This "Product Improvement Plan" would not ordinarily be imposed on the Seller if he does not sell the property. As you can see, the standards vary drastically for the minority applicant.

5. FINANCING CONDITIONED UPON OBTAINING FRANCHISE:

It is a well known fact that minorities have a difficult time accessing capital. This is especially true when you are a new entrant or a first time buyer of a business. Lack of capital, or limited capital, hampers the ability of minorities to start or purchase a business. However, in many instances, when a minority who has obtained financing and wants to purchase an independent, non-Franchised business, the financing is conditioned upon obtaining a Franchise. Many SBA lenders insist that you obtain a franchise. Hence the prospective business owner has no choice but to seek a Franchise. In many areas only one or two choices are available. Often this means he or she must choose whatever Franchise is available regardless of cost, terms and conditions the Franchisor may impose or risk losing the financing and therefore risk losing an opportunity to acquire a business.

6. MONOPOLY ON FEES, TERMS AND TERRITORIAL RIGHTS:

In many instances the Franchisor knows that your financing commitment is contingent upon obtaining a Franchise and theirs is the only one available in the area that the lender will accept. The Franchisor then has no incentive to negotiate fees, terms or conditions of the Franchise. Consequently they impose stringent conditions, less or no area of protection, higher fees, etc.

7. OTHER ISSUES THAT AFFECT ALL FRANCHISEES:

Having mentioned what are main issues facing minority Franchisees, I would like to mention other extremely vital issues that all Franchisees face but severely impact minority Franchisees in particular, because often times, they lack basic education, understanding and legal implications of Franchising. Many times, even when they understand the implications, they lack the resources to fight because of the financial limitation and also for the fear of being black-listed by the Franchisors. These issues are as follows:

1. TERRITORIAL PROTECTION (IMPACT/ ENCROACHMENT) :

A. SAME BRAND NAME IMPACT AND/OR ENCROACHMENT

The most fundamental premises on which the franchising concept was born was to have certain territorial and market protection to every Franchisee in the given market in exchange for the Franchisee paying regular royalty fees. It used to be when a Franchisor would guarantee in writing in the Franchise agreements such protection. However, in the past few years, slowly but surely many Franchisors, in their quest to expand quickly, have systematically eliminated this fundamental right to a certain territory by undermining this fundamental tenet of Franchising. In other cases where some protection is given the territories have been reduced to a street block or unreasonable small distances.

Many Franchisors now give no protection in writing in the Franchise agreements, many do not even have an Impact or encroachment policy. Many use subjective judgement while evaluating impacting Franchise applications. In almost all cases, these policies are subject to change by the Franchisor at their will. The end result is that the Franchisee is always at the mercy of the Franchisor and under the constant threat of competition from their own brand.

Since the revenue figures of all the outlets are reported to Franchisors, if the Franchisees does a good job and makes a good profit for whatever reasons, the Franchisor uses this information to put another outlet in the close proximity there by adversely affecting the existing Franchisees. Many times, such outlets are owned by the

Franchisor themselves.

Often times the Franchisee invests large sums of money, sometime their life savings to realize his or her dream of owing his business and many Franchisors, government agencies, like the Small Business Administration (SBA) and the Minority Business Development Agency (MBDA) portray Franchising as to the safest way to start a business. However, no amount of hard work, or management skill can make a Franchisee successful if he/she has no market to serve or he is not protected from cannibalization by their own Franchisor.

B. CROSS BRAND IMPACT/ENCROACHMENT:

In last few years, many Franchisors have exhausted most locations throughout the country, therefore, in their quest to increase revenue have found another way to encroach or impact the existing Franchisee, under the disguise of what they call Market Segmentation. It is by establishing another brand with little product differentiation than the existing original brand in close proximity of the existing brand. This similar but separate brand, trademarks or logo hard to distinguish from the original brand, is effectively used by Franchisors to circumvent the issue of impact or encroachment.

In many cases, original existing units do not survive or are forced into costly litigation in the Home State of the Franchisor. However, since most Franchise agreements have no written territory protection or for that matter mention of the "Impact or Encroachment policy" the Franchisee invariably lose the costly litigation. In cases where the Franchisee reluctantly wants to get out of the Franchise, he

is slapped with liquidated and other damages amounting to hundreds of thousands of dollars.

Often successful Franchisees are forced in to bankruptcy because of Impact situations. Even in cases where the Franchisee may win a costly litigation, he or she is always afraid of reprisal or retaliation by Franchisor in one or other form.

2. LIMITATION ON SOURCES OF SUPPLIERS:

Most Franchisors mandate, in their Franchise agreement, that the Franchisee purchase all supplies, furniture, fixtures, equipments, signs etc. from only approved vendors. Franchisees, in this case, have no control over pricing or the kind of the service provided by these approved vendors. Furthermore, in many small towns and remote locations often there is only one approved vendor that the Franchisee can buy from, because others may not be servicing the area or may charge you a higher price for freight and delivery because of your remote location.

This virtually creates a monopoly or oligopoly over which the Franchisee has no control. Also some local or regional supplier who may be able to supply the same items with Franchisor-approved specification at better price or better service or both, are closed out from doing business in their own community, at the expense of the local economy.

For example: In one of my hotels, we used to buy soap for $38 per case of thousand for which national supplier charged us $46 per case. This is a 20% mark-up and all added would save thousands of dollars to the Franchisee.

Mr. Chairman, I understand Franchisor specifications, quality standards and other criteria that must be met in all the products and we support rigorous standards of high quality; however, I see no reason to limit suppliers if they can meet all the

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criteria, specification and standards of the Franchisor and provide better price and better service or both.

In this day and age of mushrooming Franchising business, If action is not taken on these issues, thousands of small businesses in small communities across America may not be able to serve their own community and often may not be able to survive.

Mr. Chairman, in light of my comments, the following are my suggestions:

Comprehensive legislation is long overdue to make Franchising business such that:

1. Is equally accessible to all Franchisees regardless or their race, color, creed, sex or nationality, etc.
2. The selection criteria should be the same and consistently applied to all.
3. All Franchisees are treated equally when issues of Impact or encroachment arise. Reasonable territorial protection, Impact and encroachment policies and procedures must be a part of the Franchise agreement.
4. Terms and conditions of the Franchise agreements must be fair and equitable in all of the areas specified above.

And last, but most important, you must provide FTC with adequate staffing and funding to constantly monitor abuses and enforce fair and equitable Franchising.

Thank you for giving me chance to express my opinion. Mr. Chairman, I will be happy to answer any questions at this time.

STATEMENT OF NATHANIEL AND PATRICIA A. GRANT

"HAIR PERFORMERS ISSUES"

BEFORE THE HOUSE COMMITTEE ON SMALL BUSINESS

MINORITIES AND FRANCHISING

JUNE 30, 1993

Mr. Chairman and members of the Committee, thank you for this opportunity to share our experiences in the purchase and operation of a national franchise as minorities. Included in our written testimony are information on the status and problems of other Hair Performers and Wee Care Hair franchise owners who have experienced similar support issues.

Franchises have been tooted as a logical path for entrepreneurs, individuals that have reached the top of their career path, and those who have been laid off and have money to invest. People are getting home equity loans, small business loans, as well as, using their severance and lump sum payments to get on the bandwagon. Magazine articles have been written stressing the "success" rate of franchises. There are franchises for everything.. from shoe shine parlors to whatever your heart desires. LET THE BUYER BEWARE. We need to avoid "sophisticated scams".

In the State of Maryland, there were five existing Hair Performers at the time of our salon's opening, two closed within six months of their opening and the others closed within one to less than two years after opening. Most of the salons outside of Chicago which was the headquarters of Hair Performers experienced problems which have resulted in their closure or not being run as a Hair Performers franchise. Minority franchises in Pennsylvania, New Jersey, and California have all closed. Their are numerous non-minority salons that also have gone bankrupt or where the owners have had to walk away from the business or sell them at a considerable loss.

The beauty industry is still a segregated industry which as a normal mode of operation:

- black clients are serviced by black hairstylists/barbers
- white clients are serviced by white hairstylists/barbers
- black hairstylists/barbers mainly work in black shops
- white hairstylists/barbers mainly work in white shops
- products for black hair and products for white hair

The beauty industry is also a regulated industry. The laws and regulations vary from state to state. As a result, a franchisor should and must be capable of understanding these norms and regulations and incorporate them into their methodology. Our attraction to purchasing a Hair Performers franchise was based on three things, (1) John Amico assured us that they could support our operation as a black salon, (2) John Amico carried an ethnic line, TONITE, and (3) our not being hairstylists would not hamper our ability to be successful. However, we learned about the State of Maryland regulations on our own.

Grant and Grant Enterprises was incorporated in August 1988 for the purpose of purchasing and operating a Hair Performers franchise. The franchise was purchased on September 6, 1988 for a $15,000 fee. The franchise agreement provided the use of the Hair Performers trade mark, training, assistance in setting up and operating, and advertising. The Franchise Agreement required a 6% royalty fee and a 2% advertising fee applied to all revenue. Two loans were secured with monthly payments of $1,800 and $1,200.

The John F. Amico Company provided assistance in the selection of the location of our beauty salon to a moderately low income area of Prince Georges county, negotiations of the lease agreement, developing a business plan and loan requests. The following is a recap of costs associated with opening this business.

Franchise Fee	$15,000
Annual Rent - 1650 sq ft at $15 with operating pass through	26,700
Leasehold Improvements	50,000
Salon Furnishings	25,000
Computer Equipment/Software	5,000
Architectural Services	2,500
Working Supplies	5,000
Retail Supplies	6,000
Deposits (Rent/Utilities)	6,000
Legal Fees	1,000
Advertising	6,000
Total	$148,200

After receiving training in John Amico's Chicago office on how to run the franchise, we discovered that we were not prepared for several realities. During the first 6 months of operation, the revenue did not support the expenses and we quickly fell behind in rent payments, and royalty fees. We later renegotiated the loans to provide relief without the assistance of Hair Performers.

ADVERTISEMENT

The advertising program benefitted the Hair Performers salons in the Chicago area. There were no radio spots in the Maryland area and the grand opening print ads, which we paid $6000 to Hair Performers (this was an upfront fee that was assessed all franchise owners for assistance by Hair Performers), were placed in area mailers for only the first month of operation. We placed an additional $1500 in print ads on our own in an attempt to increase business. Each franchise in our area was responsible

for implementing its own advertising program. There was no group advertising program which would have reduced costs.

COMPENSATION SCHEDULE

We tried two compensations schedules proposed by Hair Performers. One was an hourly salary plus commissions based on an escalating compensation schedule. The second schedule was based on an escalating compensation schedule plus a service fee. We started to lose money rapidly with the compensation schedule that incorporated an hourly fee due to the fact that we were paying hairstylists to sit when there were no customers, ie we didn't have any income coming in, but we still had to produce a payroll. The second schedule caused major havoc with our hairstylists as a result of the service fee that was incorporated. This was not a tested compensation schedule in the Maryland area and was definitely a major reason for the massive staff turnovers in our salon since the schedule was not competitive nor the norm. Due to the massive staff turnovers and impossibility to attract new employees due to the compensation schedule, we had to contribute an additional $21,000 from other lines of credit to keep the business alive.

In January of 1991, we decided, on our own, to bring our operations more in line with other minority salons in the area to be more competitive. We changed our commission structure to 50% for the hairstylist and 50% for the salon. The 50% for the salon was to cover the loan payments, rent, purchase of supplies, FICA contribution, insurance payment, utilities (telephone, gas, electric, water), operating pass throughs, advertising, and other operating expenses. The cost of the loans were overwhelming and the payroll taxes, unemployment taxes, property taxes, and insurance payments continued to cause additional indebtedness using open lines of credit. After we had gotten so far behind in paying our royalty fee, Hair Performers provided $350 in advertisement assistance which had little or no impact. They still held us to paying our royalties. We then decided that the Hair Performers system was not working. In January 1992, we changed to independent contractors who paid a weekly fee for the use of their chair and salon facilities. This change greatly reduced our payroll tax liabilities and salon operating costs.

In September 1992, John Amico filed for bankruptcy selling the Hair Performers franchises to the Kelsey Company based in Chicago. We received mailings for the new ownership and requests to pay royalty fees. There was no mention of any other services to be afforded to our business. The Kelsey Company later sold the franchise rights to Barbers Salons located in Minnesota.

Following is a synopsis of our specific minority issues:

LOCATION

Location is critical to any business's success. Another beauty salon is located in the same shopping center. Running a "commissioned" salon with another salon in the same shopping center servicing the same type of clientele, was a problem. We were told by Hair Performers to not worry because "its proven system would out perform, this other salon". There are over seven salons within a two mile radius which also service the same type of clientele. We constantly had to have sales in order to attract customers. Most of our sales were relaxer sales which necessitated high supply costs with reduced income.

EQUIPMENT PURCHASES

1. Workstations:

   The workstations that we purchased from Hair Performers were not functional for black hairstylists. We had to come up with a solution on how to remedy this situation on our own. This resulted in an extra unforeseen expense to customize the stations to make them more usable by our hairstylists. Hair Performers should have foreseen this problem since they knew our salon would be a black salon.

2. Hair Dryers:

   Our hairstylists and customers have complained since day one that the dryers take too long to dry hair. This may be directly related to ethnic hair and the styles that black clientele get vs white clientele. We have, as a result, had to purchase six (6) additional dryers to compensate for this problem. Another extra and unforseen expense.

PRODUCTS

We felt it was important to purchase John Amico's ethnic line, TONITE. However, we soon learned that the product cost more, shipping costs were too high, and the product did not process the hair as fast as other ethnic lines which were less expensive and more available through local distributors. We used a lot of TONITE since Hair Performers encouraged us to use it since it could not be purchased by other salons, therefore, requiring clients to come back to our salon. We bought into that marketing philosophy even though (1) our hairstylists constantly complained that the product was not efficient and (2) the product was costly (for example, a 16oz TONITE relaxer cost $6.25 vs. other ethnic lines ranged anywhere from $3.99 - $5.50). TONITE relaxers and

curls only came in 16oz containers which was not cost effective since other ethnic lines could be purchased in larger containers (4lbs), thus offering better cost savings and usage. For example, we could purchase another ethnic product for $14.95 for a 4lb size vs. $25.00 for four 16oz containers of TONITE.

KNOWLEDGE OF ETHNIC HAIR, TRAINING, AND FILL-IN ASSISTANCE

The trainer who provided grand opening training was not familiar with the TONITE line and could not offer any pointers. Of the three local Regional Directors, two did not have licenses to operate in the State of Maryland and none of them were able to offer any assistance or pointers to our staff. Not having expertise with minority hair or licenses made them unable to provide "roll-up the sleeves" service when we did not have hairstylists to provide service or hairstylists who were having problems providing service. Therefore, their visits to our salon were basically social.

We purchased educational tapes that cost $24.95 on a monthly basis. None of these tapes included education for black hair. We stopped ordering these tapes after a year. Another unnecessary expense that was not helpful to the success of our salon.

CLOSING

Grant and Grant Enterprises hopes that the final outcome of this committee is to make it possible for franchisees who have been subjected to discriminatory conduct and left to operate without support from the franchisor be released from binding franchise agreements.

In addition, it's important for prospective franchisees to know both sides of the story:

1. Franchises, in most cases, are in the favor of the franchisor. The contract gives the franchisor the rights to everything. For example, a) no lawsuit only arbitration, b) where arbitration is held, c) if and when you can sale if the business goes sour or otherwise, and d) if the franchisor goes bankrupt, as in the case of Hair Performers, the franchisee has no say in who is the "successor" and no option as to whether you can depart the system.

2. If a franchisor goes bankrupt, the company that represents the franchisor should not be allowed to start up a similar franchise under a different name. John Amico who owned Hair Performers prior to his going bankrupt has started up WEE CARE hair, proposed as a smaller scale beauty salon built on similar methodology as Hair Performers. One WEE CARE Hair salon in Maryland has changed its name and operations while another one in Maryland is experiencing similar support issues as the Hair Performers. There appears to be the same pattern of issues for the WEE CARE Hair franchisees that occurred with the Hair Performers franchisees.

3. A franchise that is not known in your area, may not be beneficial to a prospective franchisee since there is no "name recognition", especially if the franchisor has not done an adequate job in testing the market prior to opening it up for sales. If the franchise is not a "known" entity, the franchisee's business is viewed by customers as just another business. In addition to information on the number of sales the franchisor, there should be documented information on problems in and outside of the franchisor's headquarters. Prospective franchisees should be leery of being the "guinea pig". The franchisor should establish "name recognition" in a new area first either by opening up several "company stores" or some other method.

4. Franchisors are driven by royalties and basically that's all they want. You pay and generally get nothing in return. When our business, as was the case with fellow franchise owners, was having trouble, the franchisor insisted that we pay our royalties, even though, we could not pay the rent, make loan payments, or pay our own personal bills. Our other creditors were more understanding or willing to work out a solution.

5. There should be controls implemented and limits imposed over the amount of upfront monies that a franchise owner should be required to put up. In most cases, the reason why so many franchisees fail is because they ran out of money early in operation but not out of debt.

6. The prospectus is just a marketing tool. It should include items to assist the prospective franchisee in making a good business decision, ie a)the profit and loss statement of the franchisor, b) how many franchises have failed due to bankruptcy or otherwise, not just information on the number of sales,

c) how many failed franchises are turned over to the franchisor and in what period of time, d) is the franchisor the original founder or the successor and if the successor, the successor should provide background information, ie Hair Performers went bankrupt. Hair Performers was auctioned off to Kelsy I, a Chicago firm and later was purchased by the Barbers, a Minnesota franchisor. These changes occurred in less than six months.

7. The Federal Trade Commission (FTC) and state agencies need to investigate why so many franchises fail, especially by a specific franchisor. Most of the franchises in Maryland failed in less that two years and two failed in less than six months. A Hair Performers franchise which cost $15,000 and is for 10 years. A typical building lease is for five years, loans are from five to ten years. If your franchise fails, your franchise fee which you've paid for in advance should be refunded.

8. Language should be included in the franchise agreement which holds the franchisor more accountable to the success of its franchise owners. Currently, a franchisor is permitted to include language that excludes them from guaranteeing the success of its franchisees. It should be an equitable agreement. Prospective franchisees need to be leery of the type of support franchisors say they will provide. Prospective franchisees need to ask what will franchisors do to assist in the franchise's success, ie when the going gets tough and it does, does the franchisor provide "distance" or support.

The basic underlying points are:

1) one can go into business on his/her own and avoid extra headaches of paying royalties and getting nothing in return, paying out more start-up costs because the franchisor requires your business to look like the other franchises when it really could be done for less and

2) by doing it on your own feel proud to own your own business and not feel frustrated and ridiculous for having paid a lot of money to belong to a franchise system that made you fail.

Attached are statements from:

1. Ex-Hair Performers franchise owners:

   Ellen Mackey - Germantown, Maryland
   Washington, D.C.

   Addie Pearson - Philadelphia, PA

2. An existing WEE CARE HAIR franchisee:

   Ron & Densie Royster - Lanham, Maryland

(Typed version of original submission)

HAIR PERFORMERS
GERMANTOWN, MARYLAND (closed)
WASHINGTON, D.C. (not operating as a Hair Performers)

OWNER: Ellen Mackey

In buying a franchise, I thought I was buying a proven system: training, hiring, lease, advertisement. I was sure wrong. We had help for the first five days upon opening. The we were on our own.

I paid for three franchises. I opened two after seeing what was going on, I thought it best not to go ahead. I never got money back for the one I never opened.

We paid franchise fee weekly 6% for one and 2% for advertising which we never got. We paid for our own advertising.

We paid for supplies we never used also shipping charges from Chicago.

It was a big failure from the beginning.

I was advised by Hair Performers to get a ten year lease which I did another mistake. I had to close the salon after four years which I kept open with my own money. If left furniture & fixtures... plus I had to pay for lawyers to get out of my lease which I had to pay seventeen thousand to the landlord.

I lost about two hundred thousand plus four years of Hell seven days a week out of my life for four years.

I am glad to be out of this franchise. I have my sanity back.

Sincerely,

Ellen Mackey

FROM [redacted] P.001

Page 1.

6/24/93

Allen Markey
5108 Macarthur Blvd NW
Wash DC 20016

I'm buying a Franchise thought I was buying a proven System. Training, Help, Lease Advice. I was sure wrong.
We had help for the first five days upon opening. Then we were on our own.

I Paid for three Franchises opened two after ~~being~~ being told plus going on & thought it best not to go ahead. I never got money money back for the one I never opened.

We Paid Franchise fee monthly 9% for one and 9% for advertising which we never got we Paid for our own Advertising.

We Paid for Supplies we never used. also Shipping Charges

We paid for Supplies are never used. also Shipping Charges from Chicago.

Page 2

It was a big Failure from the beginning.

I was advised by Hair Performer to get a few years lease. which I did. another mistake. I had to release the Saloon after four years which I kept open with my own money. I left Furniture. Fixtures etc. Also I had to pay for lawyers to get out of my lease. Which I had to pay seventeen Thousand to the Head Land Lord.

I lost about two hundred thousand Dollars four years of Hell Eleven days be sent out of my life for seven years.

I am glad to be out of the Travis Trade my Sanity Count.

Sincerely
C. Clark Mackey

(Typed version of original submission)
WEE CARE HAIR
LANHAM, MARYLAND (currently open)
OWNERS: Ron & Denise Royster

WEE CARE HAIR PROBLEMS

1. The lease is too high. At the prices we have, the volume of people (clients) have to be high every day.
a) Weather can cause low amount of clients.

2. Our franchisor and Development Agent(DA) had us spend more money than we borrowed. They said we had to get and fix up WEE CARE HAIRs to their specification. But when we visited our WEE CARE HAIRs, they did not have theirs expensive like ours.

3. We did not have any working capital because they made us spend all our money in building and supplies.

4. They told us we need $6000 for working capital. We said if we continue with the construction as is we will have gone into our working capital. Then they said "That's all right you don't need working capital".

5. A DA suppose to come to our salon every month to help us along. We did not see a DA for 18 months. We continuously tried to contact our DA for advice but he either say I'll get back with you or not answer our phone calls.

6. When we finally got him he said "Put on the Bunny outfit" and hung up.

7. We have been paying franchise fee since been opened and never got support from them at all.

8. The only time they call is when they want their money.

WE CARE Hair Problems

1. The Lease is too High. At the prices we have, the Volume of People (Clients) have to be High Every Day.
   A. Weather can cause Low Amount of Clients
2. Our Franchisor and DA had us Spend more Money than we borrowed. They said we had to Get and Fix up We Care Hairs to their Specification. But often we visited our We Care Hairs they did not have theirs Expensive Like ours.
3. We did not have any Working Capital because they made us Spend all our Money in Building and Supplies.
4. They told us we need $6,000 for Working Capital. We said if we continue with the Construction as is we will have gone into our Working Capital. Then they said "That's All Right You Don't need Working Capital."

(5) A DA suppose to come to our Salon every month to help us along. We did not see a DA for 18 months. We continuously tried to contact our DA for advise but no either say I'll get back with you or not answer our phone calls

(6) When we finally got him he said "put on the bunny bottle" and hung up.

(7) We have been paying franchise fee since we been opened and never got support from them at all.

(8) The only time they call is when they want their money.

Ron & Denise Royster
Owner

The following is a narrative description of the problems encountered after purchasing The Hair Performers franchise in December of 1986. The problems have been outlined as they occurred with a detailed explanation following each catagory:

(1) Finding Location

(2) Opening/Training Process of The Salon

(3) Advertisement

(4) General Help

Finding Location

The Franchise was purchased in December of 1986. It took in excess of two (2) years for a suitable location to be found. Once found, the location could not be leased due to a variety of problems; which in my opinion, may have been resolved by forceful intervention by my Franchiser. The location finally secured (One Olney Square) was recommended to Joanne by me, because it was in the surrounding area (in close proximity to my home). Tom ? was supposed to be sent from Headquarters because he is the Regional Manager for the Atlantic City area. He was sent to look over the One Olney Square location and evaluate it as an "A" or "B" location. However, I doubt if any such evaluation occurred before the location was secured by Joann, because no formal feedback was ever received by me.

Consequently the site was leased and because no prior research was conducted, I paid $12,000.00 for 4 months rent and security for the location which was an exorbitant fee; an observation which should have been made by the Franchisor to prevent unnecessary monies being spent.

Opening/Training Process

During the opening process the only tangible information I received was a booklet from Kay Cione, outlining the steps in which I was to proceed before the opening. It was months before Kay or anyone

ee advertisements directed to both black and white clientele. As you can see this, in itself, was a setback in my business growth.

Then, the most exasperating of all is that the advertising money was spent unwisely because they did a great deal of Advo ad mail-outs with val pack. I told them via the telephone that this type of advertisement was not working because time had not been alloted to send them ad recaps which, at the time, I did not know how to do.

I received no advertisements whatsoever until they received a check from me for $6,000, for which I never received an itemized list of how this money was spent.

During the month of May, I was unable to pay royalties because my expenditures were exceptionally high; and I felt it was more important to keep the shop going until I was out of the red. I spoke with someone Kay Cione recommended from Hair Performers about my financial difficulties and told me at that time they would check with me at a later date. Sometime later, I was contacted by a different person from Hair Performers who seemed to have no knowledge of my earlier conversation or problems

If the salon is to survive, effective advertising must be employed. moving in that direction, I decided to use out of pocket money to invest in some form of reasonable, affordable; effective advertising. I requested from Hair Performers headquarters an effective 2x6, 3x6, or whatever size ad for publication. Also , I requested a pre-written jingle to be aired on "Power 99", a Philadelphia based radio station with a large listening audience. Both requests were denied because had not sent recap money and was unable to pay royalties at this time. It would appear that the Franchiser would be eager to provide support in the one area that the could (advertising), since the distance between us prevents hands on assistance.

The monthly rent, $3,000.00, utilities (gas, electric and phone) and a loan payment of over a $1,000.00/month is causing a tremendous overhead. Needless to say, the salon cannot support this kind of overhead yet -- and it will not be able to support it in the future unless more effective advertisement is used as suggested earlier to increase business.

called me to find out at which step I was in, in the opening process. This certainly was not my responsibility; especially in the midst of trying to manage a new operation, to call them with information about my progress. Tom ? should have informed Kay or appointed someone here in the Philadelphia area to work with me on each step.

When I purchased this Franchise, Bill Patton told me that it was not necessary that my equipment or hair supplies be bought from the Franchiser, however, when I proceeded to purchase these items from a cheaper source; my relationship with the Franchiser changed drastically in a negative sense. Even though financial aid was available, it was not made available to me. Financing was secured entirely by myself. I was told by the Manager of the Equipment Department that I could not receive financial assistance because my equipment had been purchased elsewhere (She also informed the person in the Financial Department). I contacted your office and and informed your Secretary of the conversation with both the above mentioned parties regarding the financing.

After complaining to the Francise about the fact that I had not received any financial support and that this was, in my estimation, unfair treatment on their part; I was told that the reason for this was a $200.00 outstanding fee that was not cleared up. We both know that this could not be the reason for their lack of financial support. This all points to retalliation for non-purchase of the Franchiser's products.

In addition to the above mentioned problem of financial support, In 6/89 I ordered via telephone, call tags from Linda (from Jami Dept.) and have yet to recieve them — the boxes are still packed for shipping. The return items are from the opening that were incorrectly delivered to me. An employee (Gina) from Jami was extremely rude and provided no assistance when I called to inquire about the whereabouts of the call tags.

Advertising

Six thousand dollars ($6,000.00) was sent to Hair Performers for advertisements, none of which was spent to expose the business adequately to the public; i.e. there were no advertisements on any of the radio or television stations. There was only one zip code utilized for the mail-ins and advertisements in the local newspapers.

I believe that if proper research and evaluation of the area had been conducted, the Franchiser would have known that this is an interracial neighborhood and that advertisements must be geared to all races. Valuable time was wasted when in the beginning they sent me advertisements for an all white clientele. After informing them it was both black and white; they sent me advertisements for and all black clientele. Finally, I asked that they at least send

General Help

A trainer was sent by the name of Tom who did not take the time to review details that I thought were necessary in trying to operate an establishment of this nature. He took three days with the designers, the rest of the time was spent in my back office where he supposedly did an evaluation of the designers/stylists' work. The only consideration I was shown was an hour before his departure, when he did an actual "close out" with me. In addition, the designers were not shown how to fill out their tally sheets. His efforts were spent trying to impress the stylists with his position in the company; he was a disappointment to me.

There has been no real assistance from the Franchiser in various categories that may make a difference in the Salon's success or failure.

There is a need to hire a designer/stylist with a following - when assistance in this area was requested, Kay instructed me to look in the manual.

Since the company would like that supplies be ordered from Chicago, the savings are eaten up in shipping. The shipping costs are supposedly turned back into a savings for retirement. This is not at all cost effective for at this time I need to receive the benefits from the business now or there will not be a business later because of excessive expenditures.

When consulting Kay Cione or Mary Spidiale about any problems with the operation, I am made to feel that the Company has no obligation to the Franchisee. Also, that any problems encountered are your fault and you are not deserving of any assistance from the Franchiser.

John purchased a Cosmotology School here in Philadelphia approximately a year and a half to two years ago. I have called the school constantly for hair stylists and nail technicians. As yet, no one has responded to my requests or given me the courtesy of a return call.

I was to have someone appointed to monitor my progress periodically, however the only time I spoke with anyone was when I made contact. I am now disillusioned, because I thought I was buying into a reputable company, capable of maintaining a rapport with its Franchisee and with a policy for providing a support system to insure success. Business conducted in this manner is designed to promote failure.

Sincerely,

Addie Pearson,
Owner.

TESTIMONY

OF

RONALD E. HARRISON

PEPSICO

CHAIRMAN

MINORITIES AND WOMEN IN FRANCHISING COMMITTEE

INTERNATIONAL FRANCHISE ASSOCIATION

HEARING ON MINORITY FRANCHISING

JUNE 30, 1993

Mr. Chairman and Members of the Committee:

My name is Ronald Harrison. I am Vice President of Community Affairs at PepsiCo--the corporate entity for Pepsi-Cola, Frito-Lay, Taco Bell, KFC, and Pizza Hut. I also chair the Minorities and Women in Franchising Committee of the International Franchise Association (IFA) and serve on its Board of Directors and Educational Foundation Board of Trustees.

As stated in my letter of June 24, 1993 (copy attached), I regret that conflicts in scheduling prevent my ability to attend this hearing in person. However, for the record, I am submitting information that concerns minorities in franchising. As stated in my letter, I respectfully request that Terrian Barnes-Bryant, IFA Vice President, Research/Minority and Women's Affairs be given the opportunity to either read this material on my behalf or provide additional testimony on this important subject. As she is one of the most knowledgeable resources on the issue of minorities in franchising in the country today, I think Ms. Barnes-Bryant will be able to add valuable insight to this important discussion.

The Minorities and Women in Franchising Committee has identified, and is addressing, four areas key to increased minority participation in franchising: minority vendor and supplier programs; career opportunities; community involvement; and entrepreneurship. The committee is made up of several members of franchise corporations of varying sizes and a wide variety of industries within the Association, who have had successful experiences in developing opportunities for minorities in franchising. In our committee we hold open dialogue on potential

barriers to greater growth of minority participation in franchising and we discuss the business imperative element; that is, the importance of enhanced focusing on minorities from a business growth perspective. We share, among our members, key elements of our own company programs designed to build diversity within our corporations.

As an example, at KFC, two of our key operational vice president positions are held by African Americans who are not only trained professional managers but individuals who possess excellent sensitivities on the Black community--a consumer group that is highly valued. Also, at Taco Bell, the vice president responsible for all of California and other western states is an Hispanic American whose awareness and sensitivity to community issues has helped that corporation's growth in his region. He has developed higher employment in minority communities; a quality recruiting program with the Compton Community College that will provide more minority managers for our system; and a program for greater usage of minority contractors in building our stores.

It has been through this type of networking and sharing of our successful experiences that IFA's overall membership has begun to realize the importance of looking at the minority community as a business imperative and an essential element in long range plans for future franchise development. The vice chairs of this committee are Mr. Melvin Hopson, Director, Affirmative Action, McDonald's, and Ms. Jeanne Hitchcock, Manager, Urban Affairs, The Southland Corporation. To enhance the Committee's resources, an

Alliance for Minority Opportunities in Franchising was formed in April 1992 providing an important link to major civil rights organizations and minority economic development resource people. Founding members include Black Enterprise magazine, the NAACP, the National Urban League, the National Minority Supplier Development Council, the U.S. Hispanic Chamber of Commerce, Hispanic magazine, the U.S. Department of Commerce's Minority Business Development Agency, the U.S. Pan Asian American Chamber of Commerce, and the National Council of LaRaza. Founding Alliance member Earl G. Graves, Editor and Publisher of Black Enterprise magazine (BE), stated in his September 1992 magazine editorial, "The Alliance's cause is consistent with BE's efforts to help African-Americans profit in the franchise industry" and is "a major step in the right direction."

It is my firm belief that all of us who are interested in finding ways to advance minority entry into the economic mainstream must define positive examples and role models which will encourage other minorities to enter into the entrepreneurial arena. I have attached several items and articles for the Record relating to the success of minorities who have entered into the franchising system.

"Accentuating the positive" is the theme of our committee at the IFA. As an example, the materials attached include background and agenda details of a special conference held in Los Angeles on February 3rd of this year. During the civil unrest in South Central Los Angeles in April of 1992, not a single McDonald's restaurant was burned. Last summer, at a forum of corporate CEOs

held by the National Hispanic Corporate Council, of which I am a member, the president and CEO of McDonald's USA, Edward H. Rensi, speculated that there may well be a direct tie between McDonald's corporate philosophy of diversity, inclusion and community involvement and the perception by minority groups in Los Angeles that these McDonald's units "belong" to the community.

Last year, our IFA Committee on Minorities discussed the prospects of analyzing values generated through greater company focuses on our diverse communities. At the February 3, 1993 Los Angeles conference we conducted the first direct collaboration of IFA members and their franchisees, Alliance representatives, local community organizations and public sector entities.

Franchisor participants included American Speedy Printing Centers, Ben & Jerry's, Decorating Den, Fatburger Corporation, Host International, Inc., Hudson's Grill, Juice Club, KFC Corporation, The Krystal Company, McDonald's Corporation, Meineike Discount Muffler Shops, Mrs. Fields Cookies, Norrell Services, Inc., Numero Uno Franchise Corporation, Pedro's Tacos of California, Inc., Pepsi-Cola Company, Pizza Hut, Inc., Radio Shack, Safeguard Business Systems, Inc., Shakey's Inc., Sizzler International, Inc., The Southland Corporation, Thomas Nix Distributor, Inc., Wendy's International (a full list of attendees is attached). We gathered together to share positive experiences, explore the challenges and complexities of minority markets, and encourage greater involvement by many more franchisors in developing opportunities for minorities. We conducted a panel involving Taco Bell, KFC, 7-11

and McDonald's restaurant executives to discuss examples of community involvement. This forum also included black franchisees from McDonald's and KFC. As a result of this effort, several of our member companies are currently working in Los Angeles to explore ways to utilize the community contacts and relationships developed at the conference. This unique conference format is one which our companies, by working together through the IFA, are working to replicate around the country.

In the IFA committee format, our members use their success stories as case examples of how to develop and execute plans aimed at achieving greater participation by minorities. Mr. Fred Rasheed, Director of Economic Development for the NAACP, and an Alliance member of the IFA committee, advised me that he recently recommended that Denny's restaurants, as part of that company's efforts to improve its relations with the minority community, become a member of IFA and a part of the Committee. I believe this speaks to the importance placed on our work by a major civil rights organization.

In the final analysis, all of us who are minorities, and who are interested in the economic advancement of the minority community are aware that a long history of discrimination has been a factor that has hindered the development of our community. The issue is how do we overcome past discrimination and any further lingering discrimination that may exist in our society as we try to improve communication between our diverse cultural groups. I have tried to model many of the activities of our committee after the

efforts that PepsiCo management has employed to learn to incorporate diversity within companies and to build opportunities for minorities in all areas.

At recent discussions with House Small Business Committee staff, two Alliance members, Mr. José Niño, chairman of the U.S. Hispanic Chamber of Commerce, and Mr. Abraham Venable, chairman of the Institute for American Business, emphasized the negative impact that proposed legislation could have on franchisor initiatives, such as IFA's Alliance, that are only just beginning to bear fruit.

Looking across the small business sector of the economy, franchising is growing at an annual rate of 6 to 8 percent, creating more than 18,500 new businesses annually which in turn create more than 100,000 new jobs. And this growth occurred during the depths of the 1991 recession. It is one of the few sectors of the economy that is continuing to grow and expand successfully and rapidly. The goal of this Committee is for minorities to share in that growth and expansion; therefore, IFA and IFA members must continue to provide progressive leadership and direction in the critical area of minority business development to insure that we build upon a very positive beginning.

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ISBN 0-16-044151-X